

ANTITRUST MODERNIZATION COMMISSION

PUBLIC HEARING

Tuesday, November 8, 2005

Federal Trade Commission
Conference Center
601 New Jersey Avenue, N.W.
Washington, D.C.

The hearing convened, pursuant to notice, at 9:38 a.m.

PRESENT:

DEBORAH A. GARZA, Chairperson

JONATHAN R. YAROWSKY, Vice Chair

BOBBY R. BURCHFIELD, Commissioner

DENNIS W. CARLTON, Commissioner

MAKAN DELRAHIM, Commissioner

JONATHAN M. JACOBSON, Commissioner

DONALD G. KEMPF, JR., Commissioner

DEBRA A. VALENTINE, Commissioner

JOHN L. WARDEN, Commissioner

ALSO PRESENT:

ANDREW J. HEIMERT, Executive Director and
General Counsel

WILLIAM F. ADKINSON, JR., Counsel

TODD ANDERSON, Counsel

HIRAM ANDREWS, Law Clerk

KRISTEN M. GORZELANY, Paralegal

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Daniel Cooperman
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John E. Osborn
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Witnesses:

Susan DeSanti
Peter Detkin
Prof. Mark A. Lemley
Stephen A. Merrill
Stephen M. Pinkos
Stephen A. Stack, Jr.

These proceedings were professionally transcribed by a court reporter. The transcript has been edited by AMC staff for punctuation, spelling, and clarity, and each witness has been given an opportunity to clarify or correct his or her testimony.

P R O C E E D I N G S

CHAIRPERSON GARZA: I'd like to open the Antitrust Modernization Commission hearings for November 8, Antitrust and the New Economy. A hearty welcome to all of our panelists and our sincere thanks for your agreeing to be here and the submission of your very thoughtful papers.

Let me take a minute to explain the process, how this will work. I'll ask each of you, each of the panelists, to summarize your testimony in about five minutes. And because we have a large panel, and we do want to give adequate time for questions and answers, I'd ask you to really try hard to keep your summaries to about five minutes.

There's a box on your table and on our table with red, green, and yellow lights, and the red light means that the time is up, and if you see that light, if you haven't done so already, I ask you to please wrap it up. I'm not likely to say anything to you out of fear of being impolite, but I will be thinking to myself, "Will he wrap it up?"

Then after that, we'll do that going across the

1 table. After we've had all of your statements, then
2 we will have a lead questioner for the Commission,
3 and that's Commissioner Carlton this morning, take
4 about 20 minutes to ask questions. And then after
5 that, we will give an opportunity to each of our
6 other Commissioners, limiting them to roughly five
7 minutes each. So that's how the morning will
8 proceed. And then we will start with Mr. O'Connell.

9 PANEL I

10 MR. O'CONNELL: Thank you, Madam Chairperson.
11 Good morning. My name is Jim O'Connell, and I am
12 Counsel to the Assistant Attorney General in the
13 Antitrust Division of the Department of Justice. I'd
14 like to thank the Commission for giving me the
15 opportunity to be with you this morning to talk about
16 the issues that you all have raised regarding
17 antitrust analysis in new economy industries, or
18 industries where innovation, intellectual property,
19 and technological change are pervasive.

20 What I'd like to do in this opening statement is
21 lay a couple of background points out, briefly
22 address just a couple of the questions that you have
23 asked, and I'll try to keep it as brief as I can,

1 because I do recognize there are a number of us here
2 on the panel.

3 Many of the topics that we're here to discuss
4 this morning carry with them the suggestion that new
5 industries should perhaps be treated differently
6 under the antitrust laws than old industries, or that
7 at least they should not be subjected to the same
8 analytical process, for example, during merger
9 review. It should perhaps not surprise anyone here
10 that the Antitrust Division does not share that view.
11 A former Assistant Attorney General at the Antitrust
12 Division pointed out that when it comes to antitrust
13 enforcement, the new "new thing" often isn't so new
14 after all, and the core principles of antitrust
15 reflected in the Sherman Act are enduring rules that
16 can and should be applied to new situations.

17 Now, it is true that the federal antitrust laws,
18 at least some of them, have been around for over 100
19 years, but during that time they have repeatedly
20 demonstrated the flexibility and resiliency necessary
21 to deal effectively with rapid, indeed, sometimes
22 dramatic changes in the American economy. They've
23 served the American public well, we believe, from the

1 industrial age right up through the information age,
2 and we believe they will continue to do so in the
3 future.

4 They are flexible enough, we believe, to work in
5 all industries, including those that are constantly
6 evolving through the introduction of new
7 technologies. Of course, while the antitrust laws
8 are the same for all industries, with the exception
9 of *per se* violations antitrust analysis requires that
10 we evaluate conduct and, most particularly, mergers
11 in light of the specific facts that are involved and
12 the characteristics of the industry that is before
13 us. This is a flexible fact-based analysis that's
14 supported by sound economic principles that don't
15 change from industry to industry, and it enables us
16 to deal with industries that experience fast-paced
17 changes while serving the primary goal of protecting
18 competition in rapidly evolving markets.

19 With that as a background, I'd like to touch
20 briefly on a couple of the questions that the
21 Commission has put forth this morning. First, the
22 Commission has asked whether there should be a
23 presumption of market power in tying cases where the

1 defendant holds a patent or a copyright or some other
2 form of intellectual property. This is obviously a
3 very timely question. Since the Commission put it
4 out for public comment, the Supreme Court agreed to
5 hear the *Independent Ink* case, which is going to be
6 argued in just a couple of weeks.

7 The United States has submitted an *amicus* brief
8 in that case that is publicly available, and I'd be
9 happy to provide that to the Commission if it doesn't
10 already have it. The brief thoroughly explains the
11 government's position on these issues.

12 In short, though, for purposes of this morning's
13 hearing, I'll just say that the Division does not
14 believe that there should be a presumption of market
15 power in such cases. The government's brief in
16 *Independent Ink* explains that there is no economic
17 basis for inferring market power from the mere fact
18 that the defendant holds a patent. And while the
19 existence of a patent can, of course, be relevant to
20 the question of market power, as Professor Hovenkamp
21 said, "A patent grant creates an antitrust '
22 monopoly' only if it succeeds in giving the exclusive
23 right to make something for which there are not

1 adequate market alternatives, and for which consumers
2 would be willing to pay a monopoly price." The
3 Division does not believe that those relatively rare
4 instances where a patent actually confers significant
5 market power support a sweeping presumption of the
6 existence of that power whenever the tying product is
7 patented.

8 In the interest of time, let me skip ahead to one
9 of the other questions that you have asked: should
10 antitrust law be concerned with innovation markets,
11 and if so, how should the enforcers analyze
12 innovation markets?

13 I'd like to say as a principal, as an initial
14 matter, I'm not sure that the innovation markets
15 issue presents much of a practical problem, at least
16 at the Division. It is a theory that we apply rarely
17 in our merger analysis, and indeed, in the last ten
18 years, we've only brought one case where we alleged
19 innovation markets.

20 Innovation effects, of course, are something
21 else. The Department does care about the effects of
22 a merger on innovation, and the Horizontal Merger
23 Guidelines specifically state that sellers with

1 market power may lessen competition on non-price
2 dimensions, such as innovation. But separately
3 defining an innovation market, which is to say, a
4 market for research and development that is not
5 connected to a specific product market, is only
6 necessary, we believe, if a merger may affect
7 innovation in a way that cannot be adequately
8 addressed through the analysis of a goods or product
9 market. In 2004, I believe actually in this very
10 room, the FTC and the DOJ held a joint merger
11 workshop that had a panel devoted to this topic,
12 where the issue was discussed in some detail. The
13 general consensus at that discussion was that
14 innovation markets is a potentially useful theory,
15 but one that should be applied with caution for a
16 number of reasons, including the fact that it
17 presents particular predictive challenges, because
18 after all, in those cases, we're talking about
19 products that don't yet exist. Also, it can be
20 difficult outside of certain industries, such as
21 pharmaceuticals, to ascertain all the potential
22 sources of innovation if one is conducting an
23 innovation markets analysis.

1 The Division generally agrees with those views
2 regarding the innovation markets theory, and I'd be
3 happy to discuss that further. With that, I will
4 yield the floor to my co-panelists, and I look
5 forward to discussing these and the other issues the
6 Commission has raised further.

7 CHAIRPERSON GARZA: Thank you very much.
8 Professor Shapiro.

9 PROFESSOR SHAPIRO: Well, thank you for inviting
10 me to be here today. A great deal of attention has
11 been paid in the last ten years or longer to
12 antitrust and innovative industries, certainly going
13 back to the '95 *Intellectual Property Licensing*
14 *Guidelines*. I'm delighted the Commission is looking
15 at it. At the same time, I think we can ask, you
16 know, what is new that we want to address, given all
17 the attention that's been paid to this? I think
18 we've come a long way in the last 30 years, for
19 example. I mean, Rich Gilbert and I actually wrote a
20 paper comparing the way these issues were treated in
21 the late '90s, to the days of the nine no-no's in the
22 '70s, and I think the balance is much better in terms
23 of recognizing, for example, the many ways in which

1 various provisions in intellectual property licenses
2 can be pro-competitive without having rigid rules.

3 At the same time, I think the Commission can
4 clarify some areas here without, I think, necessarily
5 suggesting any changes in legislation) -- areas and
6 important principles, where you could focus both the
7 agencies and in general and in present, sort of,
8 views on things, including the courts, in some areas
9 that I think are tricky, not necessarily new, but
10 where I sense some confusion, and I think you can
11 maybe make an important statement.

12 So let me, in addition to -- focus on some of the
13 things I said in my written statement; let me make
14 four points in this short introductory thing here,
15 and they're all keyed in various ways to the
16 questions that you've posed. First, price-cost
17 margins. The fact is, a margin between price and
18 cost, let's say marginal cost, is a necessary and
19 desirable feature of an innovative market. That's
20 the only way companies can get a return on their R&D,
21 having such margins to pay back those fixed costs and
22 other costs associated with their R&D projects, and
23 you talk to just about any firm, they'll tell you,

1 "Well, yeah, our operating profits are such and such,
2 and we return a certain fraction of it to our R&D,"
3 so it also, as a practical matter, funds future R&D,
4 as well. As an incentive matter, it's a return to
5 previous successful projects. So the notion that a
6 gap between price and marginal cost is some sort of
7 indication that the market isn't performing well or
8 that there's -- monopoly power is mistaken, and you
9 could help clarify that. I think that does crop up
10 sometimes in an unhelpful way.

11 And I would just point out the Lerner Index,
12 price-cost margins in percentage terms, if you have a
13 very competitive market where the firms are not
14 earning any extra profits, the Lerner Index will
15 equal the ratio of the fixed cost to the revenues, as
16 a simple rule of thumb, and so it certainly should
17 not be zero if the fixed costs are significant
18 because there are R&D expenses. So that's price-cost
19 margin.

20 The second point, complements. Antitrust should
21 be very -- I think has learned a lot and should
22 continue to be flexible and learn about the
23 importance of cooperation between companies that are

1 providing complementary products. So that could be
2 hardware and software. Any time there's a system
3 that has different elements and components, it could
4 be content and distribution, and you know, the
5 economic theory here is, I think, very clear and
6 rather straight forward, that that sort of
7 cooperation could lead to lower prices and basically
8 be a win-win situation. And I think there is a
9 tendency for antitrust to, with its inherent
10 suspicion of cooperation based on collusion and the
11 lack of desirability of certain types of cooperation,
12 namely collusion between competitors, to have that
13 spill over when it's cooperation among different
14 component suppliers, and that's undesirable. And I
15 don't think it's -- I think it's well understood in
16 some circles, but it's an important message to
17 continue to emphasize.

18 Third point -- disruptive technology, and I
19 emphasize this in my written statement. The mere
20 fact that technology is changing rapidly, that
21 products are getting better, does not mean that there
22 can be no monopoly power. And I think, you know, the
23 same way we've just heard, these core principles,

1 going back to the Sherman Act, if a company has had a
2 very large share of a well defined market for a
3 considerable period of time, that is a suggestion,
4 and I don't mean more than suggestion, but a
5 suggestion that they really have monopoly power.

6 If the other conditions are met, of course, we
7 have to look at entry barriers, the ability to
8 control price, exclude competition, but the mere fact
9 that technology is changing does not undermine that,
10 okay, particularly if it's changing for exogenous
11 reasons; maybe their inputs are becoming cheaper, or
12 technologies are being developed in the scientific
13 community that are causing this rather than even the
14 firm itself being the generator of the technological
15 innovation. So I think there is some danger of
16 ignoring the concerns of monopoly power just because
17 an industry happens to be innovative. And I labeled
18 this disruptive technology because I think really one
19 of the fundamental concerns here is, we want to
20 prevent -- well, "entrenched" is a leading word -- a
21 company with a considerable vested interest in the
22 status quo, from protecting that from would-be
23 competitors with new technologies, disruptive

1 technologies, who would like to topple that *status*
2 *quo*, and that is a very important role of antitrust,
3 and it fits squarely within the Sherman Act, and so I
4 want to emphasize that, and that's not just about
5 Section 2; that's also about mergers, as far as I'm
6 concerned.

7 So fourth, patent settlements, I have written a
8 number of things about this, as have others. I think
9 there's -- I'm increasingly concerned with where the
10 courts are going in terms of giving -- allowing the
11 settlements of patent disputes that may be -- that
12 are anticompetitive. The Eleventh Circuit decision
13 in *Schering-Plough* worries me. I understand there's
14 a recent Second Circuit decision, as well. So I'm
15 very concerned about these reverse payments. I've
16 done some research on this lately, and I'm concerned
17 where the courts are going.

18 This could open possibilities to a range of
19 anticompetitive settlements of patent disputes,
20 particularly in a context where there really are
21 concerns about the quality of the patents, as you
22 will hear about this afternoon. Thank you.

23 CHAIRPERSON GARZA: Thank you. Mr. Osborn.

1 MR. OSBORN: Thank you very much for inviting me
2 here today. I know you have my written testimony, so
3 I will focus on the business perspective of mergers
4 and acquisitions, in the life sciences industry.

5 My company, Cephalon, is a small company by the
6 standards of Pfizer, Merck, or the other major
7 pharmaceutical companies, but it is a relatively
8 successful commercial enterprise from the standards
9 of the many hundreds of biotechnology companies that
10 have been established in the United States over the
11 last 20 years. We have about 2,500 employees at this
12 point, we are focused on central nervous system
13 disorders, including sleep, pain, addiction and
14 anxiety, as well as cancer, and we market products in
15 the United States and in Europe. We have a little
16 more than one billion dollars in annual revenue.

17 My experience in this area largely comes from a
18 Federal Trade Commission review of Cephalon's
19 proposal to acquire CIMA Labs. We were under review
20 by the Commission during late 2003 and much of 2004.
21 Having said that, I certainly don't want to be seen
22 as coming here to criticize the FTC, but rather to
23 provide some perspective so that this Commission

1 might consider whether our experience reflects that
2 of other firms, and if it warrants any policy
3 changes. I will make three points. I strongly
4 believe that mergers are an integral part of the
5 innovative process in life sciences. Although there
6 are well over 1,000 research-stage biotechnology
7 companies in the United States that employ
8 wonderfully creative and energetic teams of
9 scientists who develop promising research approaches
10 and innovative compounds, it is quite rare for a
11 research-stage company to develop into a mature,
12 commercial-stage firm. It is very difficult for a
13 research-stage company to develop or acquire the
14 kinds of functional expertise, whether regulatory,
15 clinical, marketing, sales, medical, to be able to
16 take those promising research leads and develop them,
17 gain FDA approval, and commercialize them. Without
18 commercialization, research innovation does not lead
19 to consumer benefit.

20 An example of this process may be seen in a deal
21 that we did back in the early 1990s, before my time
22 at the company, when Cephalon obtained an exclusive
23 license for a compound known as modafinil. At the

1 time, a small firm in France was close to obtaining
2 approval to be able to market it in that country, but
3 they had no ability to do anything in the United
4 States. Following an investment of hundreds of
5 millions of dollars in clinical studies, Cephalon now
6 has a product that is sold under the trade name
7 Provigil® for a variety of sleep disorders, and it
8 has just received an approvable letter from the FDA
9 to treat attention-deficit disorder. Thus, the
10 combination of clinical, regulatory, medical, and
11 marketing resources that we engaged has resulted in a
12 very important product for consumers in this country.

13 Similarly, Cephalon regarded CIMA Labs, which was
14 primarily a drug-development and manufacturing
15 company, as an interesting firm because of its
16 efforts to develop a product known as OraVescent
17 Fentanyl, which we saw as an opportunity to expand an
18 existing line of products. As we struggled through
19 our review process with the FTC staff, a couple of
20 things became apparent to me that perhaps would be of
21 interest to this Commission.

22 First is the question of how to properly appraise
23 risk in evaluating a merger. I certainly do not

1 suggest that merger review in an innovation industry
2 is itself problematic or unimportant, but I do think
3 that if you tend to discount substantially the
4 probability of other market entry, it will lead you
5 to oppose the proposed acquisition. Second, this
6 approach suggests that you are not really putting a
7 lot of value on the consumer benefits that may flow
8 from the ultimate consummation of the deal. And as
9 I've said, I think acquisitions, in fact, ultimately
10 add to consumer value, if they would increase the
11 odds of successful commercialization of the product.
12 I am out of time, so I will conclude by encouraging
13 the Commission to consider the ways in which risks
14 are appraised in evaluating possible market entry,
15 and in evaluating the scope of the relevant product
16 market. Thank you very much.

17 CHAIRPERSON GARZA: Thank you. Mr. Morse.

18 MR. MORSE: Thank you. I'm honored to have been
19 asked to testify before this Commission. I'm
20 currently a partner in the Washington, D.C. office of
21 Drinker, Biddle & Reath. Before joining the firm, I
22 was Assistant Director in the Federal Trade
23 Commission's Bureau of Competition. I'll offer my

1 perspective this morning based on my ten years at the
2 FTC, enforcing the antitrust laws against
3 transactions in high-tech industries, as well as my
4 years in private practice representing companies in
5 the computer hardware and software, pharmaceutical,
6 biotech, and medical device industries.

7 My message this morning is that antitrust law
8 must focus on dynamic effects to be relevant in the
9 21st century. Others have argued that innovation is
10 king for good reason. Everyone should understand
11 that small increases in productivity from innovation
12 dwarf even significant reductions in static
13 efficiency over time.

14 This reality can be grasped by considering
15 Moore's Law, which teaches that computer chip
16 capabilities double every one to two years. Slowing
17 the introduction of new and improved products in that
18 environment can harm consumers far more than even a
19 significant increase in price. That said, I agree
20 that the broad language of the Sherman and Clayton
21 Acts, the antitrust laws are sufficiently flexible to
22 take innovation concerns into account. Moreover, our
23 economic learning continues to progress. It would,

1 therefore, be a mistake to codify today's theories
2 into statute, even if there was consensus.

3 It is time, however, to update the government's
4 Merger Guidelines, which today focus primarily on the
5 ability to maintain prices above competitive levels.
6 The only mention of innovation in the Guidelines is
7 in a footnote, which states that sellers with market
8 power may also lessen competition on dimensions other
9 than price, such as product quality, service, or
10 innovation.

11 And it's far from clear that the models set forth
12 in the Guidelines to analyze price competition,
13 including the close-substitutes paradigm, translate
14 to innovation competition. I understand that debate
15 continues among economists as to whether there is
16 correlation between concentration and innovation.
17 But it is increasingly accepted that a firm's size
18 and position in a market may effect its incentive to
19 innovate.

20 Certainly, in my experience, dominant firms have
21 less incentive than a new entrant to pursue
22 disruptive leapfrog or paradigm shifting
23 technologies. Mergers of the only two firms in a

1 market pursuing R&D would appear to raise serious
2 antitrust concern. At the same time, the acquisition
3 by a leading firm of an entrant with promising
4 technology may well hasten commercialization of the
5 technology, as long as there are other firms to
6 ensure the market leader won't suppress or delay the
7 introduction.

8 Theories of competitive harm to innovation in
9 markets where there are several competitors require
10 further elucidation. Collusion or coordination or
11 coordinated interaction in R&D seems unlikely as R&D
12 is often secret and the rewards from innovation
13 great. A unilateral theory might be articulated
14 where the merging firms control the most advanced R&D
15 efforts and others are well behind, so the merged
16 firm may slow its efforts and still be the first to
17 market.

18 But while the Guidelines explain why mergers of
19 firms with products that are close substitutes may
20 lead to higher prices, it's not at all clear that
21 that theory applies to innovation. Combining similar
22 research efforts may lead to efficiencies, and the
23 merged firm, dropping one research path, may result

1 in cost savings and still leave several firms in a
2 race to innovate.

3 It is important to distinguish between research
4 and development, which is input and innovation. A
5 merger that leads to a reduction in R&D, but no
6 reduction in innovation, should be considered
7 efficient. In fact, I was member of the FTC-DOJ Task
8 Force that drafted the revised efficiencies language
9 in the current Merger Guidelines, along with
10 Commissioner Valentine and others. With respect to
11 innovation efficiencies, the 1997 Guidelines took
12 only a small step forward, noting that efficiencies
13 relating to R&D are potentially substantial, but
14 generally less susceptible to verification than other
15 efficiencies. In private practice, I found that it
16 is just such efficiencies from the combination of
17 complementary expertise, while not easily measured,
18 that drive many transactions and have great potential
19 consumer benefit. Further consideration should be
20 given to efficiencies that lead to more rapid or
21 enhanced innovation, including development of new or
22 improved products. Thank you.

23 CHAIRPERSON GARZA: Thank you. Professor

1 Gilbert.

2 PROFESSOR GILBERT: I'm grateful for the
3 opportunity to be here today. I also would caution
4 against special antitrust enforcement rules for new
5 economy industries. While dynamic, innovation-driven
6 industries have a number of characteristics that
7 challenge conventional approaches to antitrust
8 enforcement, there is nothing in antitrust policy
9 that prevents a sound analysis of competitive effects
10 in the new economy.

11 The composition of the new economy is itself
12 somewhat ambiguous. Some would say the new economy
13 consists of computers, communications, and the
14 Internet. Others would include, I'm sure John would
15 include, biotech and pharmaceuticals. In any case,
16 we can be confident that the composition of the new
17 economy is going to morph into new fields as
18 innovations change the ways that we think about old
19 activities. In some respects, advocates of an
20 antitrust exemption for the new economy, if there are
21 any such advocates, are a special interest group
22 whose members are likely to change over time.
23 Antitrust policy has served the interest of consumers

1 by resisting pressures to apply special rules and
2 enforcement standards to individual industries.

3 Innovation is a critical determinant of market
4 performance in both the new and the old economies,
5 and it's correct for the antitrust agencies to take
6 likely impacts on innovation into account when
7 reviewing mergers or other firm conduct. There are
8 two polar views of the effects of competition on
9 innovation. One view, typically associated with the
10 writings of Joseph Schumpeter back in the 1940s, is
11 that large and dominant firms provide a superior
12 platform for innovation and that new discoveries
13 arrive in frequent gales of creative destruction to
14 eliminate entrenched market power.

15 In this view, antitrust need not be concerned
16 about monopolies in innovation intensive industries,
17 because monopolies promote innovation, and whatever
18 market power may exist would only be temporary. The
19 other polar view is that competition promotes
20 innovation, both because firms and competitive
21 industries have more to gain by innovating and
22 because protection from rivalry in monopolistic
23 industries makes managers slow to adopt new

1 technologies. In this view, antitrust concerns about
2 innovation roughly parallel concerns about
3 traditional static market power. The importance of
4 innovation, which I think we all agree is very
5 important for market performance, is not well served
6 by enforcement actions that adhere categorically to
7 one or the other polar view. The relationship
8 between competition and innovation is complex, and
9 neither economic theory nor empirical evidence
10 supports a general conclusion that competition always
11 increases or always decreases incentives for
12 innovation.

13 This complexity, however, does not justify a
14 policy of denial. Antitrust enforcers should not
15 presume that because the forces of innovation are
16 complex, enforcement decisions should not even try to
17 account for the likely impacts on innovation.
18 Instead, a reasonable antitrust enforcement policy
19 would begin with a presumption that competition
20 promotes innovation. This presumption, in my view,
21 is justified, because it is consistent with a large
22 body of empirical evidence showing that competition
23 and innovation are positively correlated.

1 However, this is only a presumption, and the
2 presumption should be rebuttable. Economic theory
3 shows that competition can discourage innovation
4 under some circumstances, particularly in industries
5 in which it is difficult for firms to approximate the
6 value of their innovative efforts. And there is
7 empirical evidence that is consistent with this
8 economic theory. A rebuttable presumption that
9 competition promotes innovation would align antitrust
10 policy with the substantial body of empirical
11 evidence that shows a synergy between competition and
12 innovation while preserving the ability to present
13 contrary evidence when warranted by particular
14 circumstances. Thank you.

15 CHAIRPERSON GARZA: Thank you. Mr. Cooperman.

16 MR. COOPERMAN: Good morning. I would like to
17 focus my remarks this morning on some practical
18 aspects of antitrust enforcement that affect
19 transactions proposed by software companies and
20 others in the new economy. At the outset, I'd like
21 to emphasize that time is precious in the software
22 industry. Competition in our markets develops with
23 extraordinary speed. New entrants can quickly

1 displace incumbents.

2 The cycle of innovation in the software industry
3 is measured in days, in months, and not in years.
4 When a transaction is held up, product design
5 decisions, the core of innovation, may come to a
6 complete halt, because the merging companies cannot
7 predict which resources from each company will be at
8 their disposal and when. The resulting delay may
9 deal a fatal blow to an otherwise pro-competitive
10 merger transaction.

11 For that reason, the fragmentation of the merger
12 clearance process internationally has become a
13 critical issue for new economy companies. Because
14 their business does not depend on significant
15 physical facilities, new economy companies often do
16 business in a large number of jurisdictions. That is
17 especially true for companies involved in software or
18 software-driven services, where a product can be
19 distributed and sold anywhere in the world with
20 relatively little additional expense. About 60
21 nations have some form of pre-merger clearance
22 systems. The wide divergence in rules, procedures,
23 and standards presents significant hurdles to any

1 company that is trying to close a deal without
2 violating any nation's laws, especially because
3 failing to file a required notification can result in
4 a fine or even in a divestiture or unwinding order.

5 Now, let me be clear; I completely understand
6 that with the proliferation of pre-merger clearance
7 regimes around the world inevitably come differences
8 in substantive antitrust standards of consideration
9 and approval; that is as it should be. Each nation
10 has its own legal standards, and conflicts of some
11 kind are almost inevitable when different
12 jurisdictions apply differing analysis to the same
13 transactions. Transacting parties have to hope that
14 the conflicts do not reach the core of the deal and
15 that one's jurisdictions cure is not another's harm.

16 Today, however, I'd like to address a problem
17 that I hope can be fixed more easily, that is the
18 procedural mine-field that awaits any party that
19 engages in a merger or acquisition that implicates
20 multiple jurisdictions around the world. Merging
21 parties commonly need to file in a dozen or more
22 different jurisdictions. We suggest closer
23 international coordination to produce streamlined

1 pre-merger notification, a coordinated investigation
2 protocol, and dispositions that occur within a single
3 agreed upon limited time. I will explain our
4 perspective on the problem along with the solutions
5 we propose. Some countries require filings as soon
6 as a week after the execution of the merger
7 agreement. Different countries also have different
8 rules about follow-up information requests, so that
9 companies must engage in a series of search and
10 production exercises over a period that may extend to
11 several months.

12 The enforcement agencies also start and finish
13 their investigations according to different
14 timetables, so that the jurisdiction with the closest
15 connection to the deal may not be the first to rule
16 on the transaction. For example, in mergers between
17 U.S. companies, the European Commission may issue a
18 decision that includes recommended dispositions or
19 licenses that address a perceived competition issue
20 even before the responsible U.S. agency has even
21 completed its review.

22 Moreover, software companies may be uniquely
23 susceptible to substantive variations between

1 jurisdictions. Because software products
2 increasingly are offered for purchase and download
3 directly over the Internet, it is virtually
4 impossible to refrain from doing business in any
5 jurisdiction. As a result, the jurisdiction with the
6 strictest antitrust review procedures or the lowest
7 jurisdictional standards may dictate the timing and
8 the substantive result for all other jurisdictions,
9 leading to what I call a highest common denominator
10 solution that may not be the most efficient or
11 economically sound. But the hardest part is knowing
12 where to file. The economic thresholds for a
13 jurisdiction, and the filing scope, often are not
14 confined to the transactions effect in a particular
15 country, and the filing thresholds often do not
16 clearly distinguish between worldwide economic
17 activity and activity within a jurisdiction. The
18 complexities of modern business transactions can
19 combine with the complexities of jurisdictional rules
20 to produce compliance traps.

21 This regulatory disarray imposes real costs on
22 productive commerce. The combination of expense,
23 legal risk, uncertainty, and delay will deter pro-

1 competitive transactions on the margin. The
2 deterrence because of substantive competitive
3 concerns may benefit consumers, because the deterred
4 transactions are at least arguably anticompetitive,
5 but by contrast, deterring substantively pro-
6 competitive transactions based on mere procedural
7 impediments creates a deadweight lost.

8 We would call on the Commission and on the
9 federal enforcement authorities to spearhead
10 procedural reform of the international merger
11 investigation regime by enlisting the involvement of
12 the United States Trade Representative, if necessary.
13 We believe that the filing, information gathering,
14 and statutory review periods for merger
15 investigations could be substantially coordinated by
16 taking just a few simple steps. First, there should
17 be a standard form for information requests with a
18 single set of filing dates for initial and follow-up
19 submissions. Companies should be able to file one
20 set of information to which all interested
21 jurisdictions have access. Second, the antitrust
22 enforcement agency of the domicile of the acquiring
23 company should be the primary investigating agency.

1 Other countries would channel additional information
2 requests through that agency to reduce duplication.
3 That would permit companies to provide fewer but more
4 comprehensive responses, reducing the risk of
5 inadvertent non-compliance, without reducing the
6 volume and quality of relevant information.

7 Third, the investigations of various antitrust
8 authorities should take place concurrently. The
9 common information submissions would feed into a
10 multiplicity of merger review processes on a
11 coordinated schedule. And finally, the primary
12 investigating agency should complete its
13 investigation and any resulting enforcement activity
14 first, before other non-primary agencies within a
15 strictly limited time frame could bring enforcement
16 actions for additional relief.

17 The agencies in the non-primary states
18 accordingly could focus on regional and local issues
19 that were less likely to be adequately addressed by
20 the primary agency. In conclusion, these modest
21 steps and procedural streamlining could render the
22 procedural aspects of merger review less *ad hoc*, more
23 efficient, and more predictable, with far fewer traps

1 for the unwary. I note that antitrust law aims at
2 preserving the innovation and efficiency provided by
3 competition in the marketplace. Antitrust
4 enforcement itself should aim to be just as efficient
5 and nimble as the companies it regulates. I thank
6 you for your attention.

7 CHAIRPERSON GARZA: Thank you. Commissioner
8 Carlton.

9 COMMISSIONER CARLTON: Okay. Thank you, and I
10 want to thank the panelists. I read all your
11 statements, and I appreciate all the hard work that
12 went into them. I only have 20 minutes to ask you
13 questions, and there are six of you, and I have 20
14 minutes of questions for each of you, so I would ask
15 you to try and keep your responses to my questions,
16 if you can, short, so we can cover more topics.

17 I want to start out really following up on
18 something that Professor Shapiro, Carl, said, and
19 that is, there's often a confusion between price
20 above marginal cost, and market power, rates of
21 return, and I want to explore that a little bit, and
22 I want to really focus on the economists on the panel
23 to answer the question.

1 We don't need new economic principles, I think
2 both of you would agree, to analyze a high-tech
3 industry versus a low-tech industry, the application
4 will differ obviously. What a high-tech industry
5 puts in stark contrast, though, is that there are
6 high fixed costs, and low or zero marginal costs. So
7 the question is, what do you mean by market power?
8 If price is above marginal cost, both of you point to
9 that would seem like a funny definition to say that's
10 market power because every industry would have market
11 power. And both of you in your statements say that's
12 not market power in an antitrust sense. And I think,
13 Carl, you used the language -- it's not durable
14 monopoly power; it's not genuine monopoly power. And
15 I really want to make sure I understand the
16 distinction that you're drawing.

17 I know you're not proposing that price above
18 marginal-cost be the screen for market power. It
19 sounds to me like, since I'm an economist, as you are
20 -- I know marginal cost; I know rates of return -- it
21 sounds like you're saying that there's not market
22 power, durable market power, unless the level of
23 profit, the rate of return, is above the competitive

1 level; is that what you guys are saying, and if so,
2 over what length of time would you calculate this
3 rate of return? So why don't I start with Rich and
4 then Carl?

5 PROFESSOR GILBERT: Well, I think antitrust
6 policy has been generally correct in the way it's
7 looked at the market power issue, in that it's not
8 really so much -- antitrust has not been so much
9 concerned about actually measuring the Lerner Index
10 or rates of return, but rather investigating when
11 market power is an issue for antitrust purposes, and
12 so the absence of market power, is a good starting
13 point, for there is not an antitrust problem. So if
14 we don't see any market power, we can say there's no
15 antitrust problem. Now, of course, in many
16 industries, and particularly high-tech industries,
17 you're always going to see high price-cost margins
18 and always some theoretical evidence of market power.
19 But then antitrust asks the correct question, I
20 believe, which is, in a merger case, is the merger
21 going to raise prices substantially or limit output
22 or reduce innovation? And in a unilateral conduct
23 case, is there conduct that leads to either higher

1 price-cost margins or sustains price-cost margins in
2 ways that are anticompetitive?

3 So the use of market power as a screen seems to
4 me to be the right thing, and then applying market
5 power to the relevant questions seems to be done in
6 the correct way by antitrust enforcement agencies for
7 new and old economy industries.

8 COMMISSIONER CARLTON: Yeah, so let me -- I think
9 that's exactly right. The way I think about it is
10 that the antitrust laws are trying to see, in a
11 merger case, is the price going to go up as a result
12 of the merger? And in a monopolization case, as a
13 result of a bad act, is price going up, meaning, is
14 there an increase in elevation of price above
15 marginal cost?

16 The reason we have market power and focus on
17 market power is, we want to throw out cases, not clog
18 up our administrative system. It really doesn't
19 raise significant issues. And for that, we define a
20 market, and we want to say that if a person doesn't
21 have market power, let's forget about the case. And
22 my question is, both you and Carl are saying that
23 durable market power has to be a high rate of return,

1 and that suggests that you're going to have to start
2 measuring rates of return, and to do that, you're
3 going to have to have some time interval over which
4 you measure it, and so that's my -- I think that's --
5 that's my thinking on -- my interpretation of what
6 you guys are saying. It sounds right; that's similar
7 to my thinking on the topic, I just wanted to -- what
8 do you think, Carl?

9 PROFESSOR SHAPIRO: Well, I think if you were
10 just doing it conceptually, that's right, if you're
11 not going to compare price to marginal cost. Is it
12 some sort of average cost? Is there a rate of
13 return? How are you going adjust for risk? That
14 gets to be difficult, and it raises the time-frame
15 issue, no question. But in practice, let me give you
16 an example. I had a case once for Apple Computer,
17 and it was accused of being a monopolist over
18 basically Apple computers. And, you know, I think
19 most people are like, "Well, that's crazy; they have
20 to compete against Microsoft; they've got to compete
21 against, you know, -- machines, whatever it is. That
22 doesn't make any sense."

23 But, in fact, they had authorized some cloning of

1 Apple computers, and then they withdrew allegedly, so
2 now the question was, well, had they done something
3 that had actually allowed them to get a higher price
4 at reduced -- eliminated some type of maybe called
5 localized competition that would have pushed down
6 price. So then you get to the practical question,
7 well, did the conduct actually lead to significantly
8 higher prices, whether or not they were getting --
9 regardless of just how good their return on their R&D
10 investments was? So you start to pose that practical
11 question. You don't really need to necessarily get
12 into measuring risk-adjusted rates of return, and in
13 a merger case it's the same thing. I mean, you may
14 have very large R&D investments, but now they're
15 sunk, and if the merger allows the firms to raise
16 prices, we don't necessarily care whether it's above
17 or below a competitive rate of return, because, in
18 the long run, the merger is having certain effects.

19 COMMISSIONER CARLTON: That sounds right --

20 PROFESSOR SHAPIRO: Oh, good; I'm glad.

21 COMMISSIONER CARLTON: -- and that's focusing on
22 what the effect of the price going up is, but it
23 seems to me the administrative reason that lawyers

1 like to say there's no market power in a Section 2
2 case is, you don't address those issues, so that even
3 if you -- if someone comes to you, a defendant in a
4 monopolization case, and you say, "I can prove to you
5 that your price is way above marginal cost, but the
6 bad acts aren't raising prices," the lawyer will
7 typically say, "Well, can you also say I don't have
8 market power, if I can just get this case thrown out
9 at the beginning?" In other words, that's the
10 initial screen, and that, it seems to me, is why
11 there's so much emphasis in our system on market
12 power. And it does seem to me that economists waver
13 a little bit in the precise definition of what that
14 first screen is. Even though I agree with you, the
15 focus that economists can bring to the table is
16 really that second element -- price going to go up --
17 and that seems to me the source of a lot of confusion
18 in the legal writing in the courts. And the
19 difficulty it raises is, you do have to say, "Is the
20 rate of return a little too high?" And then you get
21 into some difficult problems. All right. Let me go
22 on.

23 Is there anyone on the panel who believes that

1 tying of a patented product should create the
2 presumption that, when that occurs, there's market
3 power? That's one of the questions I think you were
4 all unanimous in saying that the mere fact that you
5 have a patent shouldn't give the presumption of
6 market power. I just want to make sure everybody --
7 I was reading everyone's statement. Does everyone
8 disagree with that statement? Good, okay.

9 Let me ask a question that didn't come up in the
10 panel's oral comments but did in the written comments
11 of Mr. Morse and Professor Shapiro, and it has to do
12 with networks, which I think is also an important
13 topic in the new economy. Suppose that networks
14 interconnect with each other initially, and then
15 suppose the industry grows, and one network gets a
16 little bigger than the other network and stops
17 interconnecting; should that be an antitrust
18 violation, or can that be an antitrust violation? So
19 let me first ask Mr. Morse that question.

20 MR. MORSE: Well, I start with the presumption
21 that network effects are a given in certain markets
22 that we're dealing with and are increasingly common
23 in the high-tech sector, but as has been pointed out,

1 it is not necessarily a new feature. The network
2 effects, you know, create both efficiencies, which
3 are a good thing, and they create barriers to entry
4 or switching costs, and I think that, you know,
5 therefore, we want to look carefully at them, whether
6 we're dealing with mergers or monopolization conduct.

7 I think your specific question, which is, does
8 simply the denial of access to a network, as I
9 understand the question, create a monopolization
10 question? I think it's a difficult issue. When
11 companies never allow access, we don't usually think
12 that there's a problem, but when they quit providing
13 access, as in *Aspen Skiing*, then occasionally
14 questions are raised, but I think it certainly should
15 be, as the Court most recently said in -- rare that
16 we insist upon access.

17 COMMISSIONER CARLTON: Carl.

18 PROFESSOR SHAPIRO: Well, Dennis, I know what a
19 fan you are of the *Aspen* case, so I won't mention
20 that one.

21 COMMISSIONER CARLTON: Thank you.

22 PROFESSOR SHAPIRO: My short answer is, yes, it
23 can be, such refusal, changing of interconnection

1 policies, in particular, if there's been some
2 representation that there would be interconnection.
3 In that case, very possibly, one company managed to
4 grow its network with certain promises of openness,
5 open interfaces or interconnection, and if that's
6 withdrawn, that could lead to market power, monopoly
7 power, and harm to consumers, and that seems to me to
8 then go beyond simply a, I don't know, a tort or
9 contract issue to potentially become an antitrust
10 issue.

11 COMMISSIONER CARLTON: Okay. Let me ask Mr.
12 Cooperman; your statement I think makes crystal clear
13 that time is of the essence in these high-tech
14 industries, and you talk mainly in the context of
15 mergers and the difficulty and sometimes the
16 nightmarish difficulty there must be to get a big
17 transaction through. But isn't there -- I want to
18 apply that idea to monopolization cases.

19 Would the implication of what you're saying be
20 the following, that if there's a bad act created, it
21 could do in the rival pretty quickly, and therefore,
22 maybe in -- and by the time the courts administer the
23 case, you know, it's too late to resurrect the rival

1 who's dead, so would that suggest, or would you
2 suggest, therefore, in Section 2 cases, in these
3 high-tech industries, that the standards for, say, a
4 preliminary injunction based on irreparable harm be
5 used to prevent defendants from engaging in bad acts
6 if the court thinks that it is a rapidly changing
7 industry and the bad act will do in the rival?

8 MR. COOPERMAN: Well, certainly; as I said, I
9 think time is of the essence. I don't think it
10 requires a change in the standards for some type of
11 remedial relief in the interim. But I think courts,
12 in administering the case, overseeing the case, need
13 to be particularly mindful of the impact of time, of
14 the passage of time, and need to move the case along
15 with dispatch. But I don't think the legal standards
16 for remedial relief really ought to be changed.

17 COMMISSIONER CARLTON: Okay. Let me just briefly
18 turn to innovation markets. I wanted to ask Mr.
19 O'Connell, you spoke of the ZF/GM case, which was the
20 one case where -- or the initial case where
21 innovation markets were brought, and I should reveal
22 that I was involved in that case. And with due
23 respect to my friend, Rich, I don't have the same

1 view of innovation markets as he does, but I wanted
2 to follow up on that.

3 Do you know, in fact, whether innovation occurred
4 in the ZF/GM case as a result of stopping the merger
5 in transmissions, which was what was alleged to have
6 occurred? So if we called up GM today and I asked,
7 "Did either ZF or GM engage in the innovations? Did
8 it occur?" -- Do you know that?

9 MR. O'CONNELL: I don't know that for a fact. I
10 actually was not involved in that case, although I am
11 familiar with it.

12 COMMISSIONER CARLTON: Okay.

13 MR. O'CONNELL: But I don't know.

14 COMMISSIONER CARLTON: Okay.

15 PROFESSOR GILBERT: I was, so I can say
16 something.

17 COMMISSIONER CARLTON: Well, okay, yeah, Rich,
18 why don't you?

19 PROFESSOR GILBERT: I haven't followed up on the
20 actual innovation story, but I think people who have
21 written on that case, and I know you have, and I
22 appreciate your insights, but I think there's one
23 thing that's been overlooked, Dennis, which is that,

1 you know, the case was really about competition in
2 Europe; it was not about competition in the U.S. And
3 it was the concern that the complete absence of
4 competition in Europe, which would have happened,
5 were those were the two only major producers, if they
6 had merged, the consequences for the U.S. market
7 could have been significant. And procedurally, you
8 can't do anything about -- from the U.S. side, --
9 what's going on in Europe.

10 So I think in analyzing what happened in that
11 case or what could have happened with or without that
12 case, you really have to look at what was going on in
13 Europe, and that's a hard but-for calculation.

14 COMMISSIONER CARLTON: Okay. Mr. Osborn, you
15 criticize innovation markets in your testimony, and
16 although I am a critic of innovation markets, one of
17 the few exceptions to innovation markets where people
18 say, "Maybe it works," is the drug industry, because
19 you can see the pipeline, and in fact, if you see the
20 pipeline of products coming out, you can actually say
21 it's a product market or a future product market
22 case.

23 But your testimony I think would lead one to

1 question the value of innovation markets even in the
2 drug field; am I reading your testimony correctly?

3 MR. OSBORN: I think you're talking to Mr. Morse,
4 aren't you?

5 COMMISSIONER CARLTON: Yes, I'm sorry.

6 MR. OSBORN: I'm quite fond of innovation and
7 life sciences, and I believe it's pretty important
8 actually.

9 COMMISSIONER CARLTON: Well, I was asking Mr.
10 Osborn because you talked about the difficulties and
11 uncertainties, I thought, of administering the merger
12 process at the FTC and how they -- it's very
13 speculative, and that's been the criticism of
14 innovation markets, and I thought that you were,
15 therefore, saying that you would even attack that
16 concept in the case of product markets, but that's
17 all right, let's just -- maybe I misread.

18 MR. OSBORN: Well, I probably was thinking of
19 innovation, not in the economic sense, and I did --
20 what I tried to express in my written testimony was
21 that, while there is necessarily uncertainty in any
22 effort to predict the effects of a merger, at least
23 in our experience, the perspective of the Commission

1 staff was to resolve the uncertainties against the
2 proposed merger.

3 If there were possibilities of generic entry,
4 those possibilities tended to be discounted heavily;
5 if there were possibilities of other proprietary
6 products coming in, they were discounted heavily; if
7 there were any distinguishing features between
8 products, there was a seeming unwillingness to
9 evaluate in a sophisticated way whether they were
10 really functionally interchangeable, or how
11 physicians might regard the products. And it seemed
12 to me that the process inevitably was skewed toward
13 opposition to the proposed merger without giving much
14 weight to the value of our ability to leverage our
15 firm's assets to effectively commercialize the
16 product.

17 COMMISSIONER CARLTON: Okay, thank you. Let me
18 ask a question of Mr. Morse. You stressed how
19 important innovation was in these new economy
20 industries, and I think that's absolutely right,
21 innovation is responsible for our improved standard
22 of living. Here's the question I have to you; if
23 there's a merger case and you know innovation may be

1 involved, what you're worried about is, well, if I
2 stop the merger, I prevent new products from coming
3 out; that's a tremendous cost to the economy if new
4 products would come out as a result of the merger.
5 On the other hand, if I stop a merger that would, as
6 a result of stopping the merger, create more
7 competition in innovation, then that's a benefit.

8 So it seems to me that, although you're correct
9 to point out that we should pay a lot of attention to
10 innovation and its effect on mergers, it's very hard
11 for us to predict it, and I can't figure out -- do
12 you think the Type One errors are worse than the Type
13 Two errors, that is, how are we going to -- there are
14 two types of mistakes you can make, and balancing
15 those mistakes is what's going to determine how you
16 decide issues, and I'm trying to say -- are you
17 saying we should tip the balance more in favor or
18 less in favor, other than, you know, trying to do the
19 best job we can?

20 MR. MORSE: Two thoughts in response to that;
21 one, I am probably very concerned about it in the
22 merger-to-monopoly situation. I think that when
23 you've got the only two firms there, the possibility

1 of delay is much greater, and the models about which
2 the economists can speak are much greater than that
3 in single firm conduct, and incentives to innovate at
4 least fall in the category where Professor Gilbert
5 has said there should be a strong presumption.

6 I am much less sanguine that there should be
7 concerns about mergers, say four-to-three players,
8 because I think of the difficulty of collusion in
9 R&D, and I don't think that the unilateral close-
10 substitutes model applies to that sort of
11 combination. I think it is essential, though, that
12 the agencies articulate as clearly as possible the
13 models that they operate under and that it's an
14 insufficient answer to say that the cases are case
15 specific. Case-specific analysis leaves too much
16 discretion in junior staff, and that there is a need
17 for broad principles to which the staff can look and
18 to which parties can look in doing the analysis.

19 COMMISSIONER CARLTON: Okay, thank you. I'm out
20 of time, and I have more questions, especially for
21 Rich and Carl. But let me just end with one quick
22 question to Carl. In your paper, in your discussion,
23 you talk about the problem of weak patents, and you

1 refer to some other papers you've written on that,
2 and I was wondering, could you just take a minute to
3 explain what you're referring to, so you can explain
4 it a little more clearly than in your statement?

5 PROFESSOR SHAPIRO: Certainly, thank you. I
6 mean, just by definition, we could think of patent
7 strength as the -- how likely it is that it will be
8 held valid if it's, in fact, litigated, and no doubt,
9 there are some patents that are very strong in that
10 sense; some are very weak, and the FTC report that
11 you all know about and -- talk about asks, are there
12 more questionable, or I might say "weak," patents
13 that are being issued?

14 If a weak patent -- if any patent is asserted
15 against a competitor, I think of it
16 probabilistically, that is, well, maybe the patent is
17 valid, in which case the competitor could be
18 legitimately excluded from the market: let's say the
19 competitor cannot compete without infringing. On the
20 other hand, if the patent is invalid, the field would
21 be wide open, and we'd have more competition.

22 An agreement between the patent holder and the
23 alleged infringer that totally eliminated the

1 competitor or caused the competitor to leave the
2 market might be quite suitable if the patent were
3 known to be very strong, but it would lead to a
4 significant reduction in competition if the patent
5 were, in fact, thought to be very weak, when we
6 really should sort of expect -- at least if there
7 were litigation, we would have a high likelihood of
8 invalidity, and, therefore, a more competitive
9 outcome. So that's the notion, and then it has
10 particular implications, I think, for patent
11 settlements, which I mentioned is one of my areas of
12 concern.

13 COMMISSIONER CARLTON: Thank you.

14 CHAIRPERSON GARZA: Commissioner Warden.

15 COMMISSIONER WARDEN: Thank you. I think that
16 everyone here would probably agree that all of what
17 Mr. Cooperman asks for, he should be given, were it
18 within our power to do so. My question to Mr.
19 O'Connell is, how likely is it in the real world that
20 we're going to get any of what Mr. Cooperman wants?

21 MR. O'CONNELL: Well, first I should say, I do
22 sympathize with the problem Mr. Cooperman
23 articulated. I spent a lot of time as a very junior

1 antitrust associate devising chart after chart,
2 charting all the jurisdictions where a client
3 potentially had to file a merger notification, all
4 the standards, and for every transaction the chart
5 got longer, the file kept crashing, it was too big,
6 it was a growing problem, and I do sympathize, and
7 the Division recognizes that that's an issue.

8 I don't know that I could comment on how likely
9 it is that we're going to get the kind of relief that
10 Mr. Cooperman is talking about. But I will say that
11 the Division works very hard with the enforcers in
12 other jurisdictions, and communicates with them
13 frequently when it's conducting investigations in
14 particular, but also on these larger policy questions
15 through the ICN, the OECD, and the other groups to
16 try to alleviate the problems that he's articulated.
17 We do recognize that this is a significant drain on
18 resources, and it makes the merger review process
19 significantly more complicated than perhaps it needs
20 to be.

21 COMMISSIONER WARDEN: My next question is for
22 both Mr. O'Connell and Mr. Morse, in turn. I found
23 Mr. Osborn's written statement very interesting, and

1 I would like to ask each of you in turn if you think
2 that it is an accurate portrayal, based as it is on
3 one merger, of the attitudes of the merger review
4 people in the DOJ and in the FTC?

5 MR. O'CONNELL: Well, I can't speak to,
6 obviously, the particular circumstance, and mergers
7 in that industry, as everyone here knows, are not
8 generally something that the Division looks at. I
9 hesitate to make general characterizations about what
10 individuals might be thinking, but I don't think that
11 that represents the approach that is taken at the
12 Antitrust Division. We do take these cases, each
13 one, on a case-by-case basis.

14 The facts of every transaction that we look at,
15 every industry, are different, and the system that we
16 use to analyze these transactions we believe is
17 sufficiently flexible to take into account all of
18 those different facts. I noticed, for example, that
19 Mr. Osborn alluded, in his written testimony, to
20 something of a general anti-merger bias, and while
21 that may be the case on the part of this or that
22 staff member in one or the other agency occasionally,
23 I do not think that is a pervasive bias, certainly

1 not at the Antitrust Division.

2 COMMISSIONER WARDEN: Mr. Morse, as to the FTC.

3 MR. MORSE: Well, I have tremendous respect for
4 the staff at the Commission. I've worked with them
5 closely for a long time, you know. There are a large
6 number of incredibly dedicated career civil service
7 people in the agencies who work incredibly long hours
8 at their mission, and that mission is to protect
9 competition and to protect consumers. And, you know,
10 as a manager at the staff, I occasionally disagreed
11 with my staff, as well. So I think, you know,
12 parties who are approaching the Commission have to
13 educate the staff about the matter that they're
14 dealing with, and I think for the most part, the
15 Commission gets it right.

16 COMMISSIONER WARDEN: Carl, do you see anything
17 you recognize in Mr. Osborn's statement?

18 PROFESSOR SHAPIRO: Yes, I do. I think --
19 sometimes I work for the agency, and sometimes I work
20 for private parties, so I have both perspectives in a
21 way, without being a staff member there. But I think
22 it's natural, human nature, for people to say, "Well,
23 how do I build my case? How do I make it strongest?"

1 and also, on the agency side, to say, "We're out
2 here; we have to be somewhat skeptical of what we
3 hear from the parties," and you know, that's going to
4 play out differently with different individual staff
5 members, different cases. But, sure, I see that type
6 of thing sometimes, but again, I wouldn't want to
7 generalize.

8 COMMISSIONER WARDEN: Do you agree that it's
9 appropriate for an agency to take the position, "We
10 don't do risk"?

11 PROFESSOR SHAPIRO: Well, they do risk whether
12 they want to or not. There are, you know -- one
13 thing I thought reading Mr. Osborn's statement and
14 hearing him talk was, you know, the other risk is,
15 well, what's the risk of slowing up or stopping the
16 pro-competitive aspects, and I would just say -- I
17 mean when I have clients, I say, "Well, let's get --
18 let's understand what the pro-competitive aspects of
19 this deal are, because ultimately it's going to be
20 some sort of balancing, and so the risk has to be
21 considered on both sides."

22 COMMISSIONER WARDEN: Thank you.

23 CHAIRPERSON GARZA: Okay. Commissioner Delrahim.

1 COMMISSIONER DELRAHIM: Thank you. Let me ask a
2 question that came up in a prior hearing dealing with
3 Section 2, and there seems to be some debate as to
4 whether or not the unilateral refusal to license a
5 patent should be -- and if so, in what circumstances
6 should that be -- a violation of the antitrust laws?
7 And is there anybody on the panel who would think
8 that the unilateral refusal to license intellectual
9 property, whether it's a patent or a copyright, could
10 be in violation of antitrust law? We'll start with
11 Mr. Shapiro.

12 PROFESSOR SHAPIRO: Well, yes, it could,
13 depending on, for example, conditions that were
14 imposed associated with the license.

15 COMMISSIONER DELRAHIM: I should clarify that,
16 unconditional refusal to license.

17 PROFESSOR SHAPIRO: Well, as you know, we had a
18 hearing that we talked -- I was at the hearing where
19 we talked about this. So generally, no, although it
20 would be my view that there is the situation where
21 there's a change of policy, for example, a
22 misrepresentation to an unconditional refusal from
23 previous licensing. I wouldn't want to -- excuse me,

1 that could raise issues, but generally, no, if it's
2 unconditional and just flat.

3 COMMISSIONER DELRAHIM: Mr. Gilbert.

4 MR. GILBERT: Well, as you know, there's already
5 the amendment to the Patent Act that says that a
6 refusal to license intellectual property cannot be a
7 basis of a patent misuse. And it doesn't take much
8 of a step to say, "Well, it can't be an antitrust
9 violation either." So if we're just talking about an
10 unconditional refusal to license, I don't see how
11 that can be an antitrust violation.

12 Now, I do believe that there could be a set of
13 circumstances in which -- I think Carl said it well -
14 - refusals to deal is one thing, but a conditional
15 refusal to deal might be another thing. There I
16 would apply similar approaches that we apply to
17 conventional property in thinking about refusals to
18 deal. I don't think intellectual properties are
19 particularly different from other forms of property
20 in that regard, but it does have the protections
21 against an unconditional refusal to deal.

22 COMMISSIONER DELRAHIM: Mr. O'Connell.

23 MR. O'CONNELL: I don't know that I have anything

1 specifically to add to that. I generally agree with
2 the statements that Dr. Shapiro and Gilbert have made
3 on that point.

4 COMMISSIONER DELRAHIM: Mr. Morse, I know you did
5 not come here as a proxy for the Federal Trade
6 Commission, but given your vast experience there,
7 would you like to comment on that, giving some of the
8 differences that appear to emanate from the FTC?

9 MR. MORSE: I certainly would not want to pretend
10 that on this issue that I would speak for the
11 Commission. I agree with what's been said: the very
12 essence of intellectual property is the right to
13 exclude others. It seems to me it would be anomalous
14 for antitrust law to impose an obligation to license
15 on a firm that unilaterally refuses to license. And
16 as it's been said, I think the key issue is defining
17 what is unilateral, not through agreement with
18 others, not conditioning, and I think that, you know,
19 that we should have concerns, not only what's
20 happening in the U.S. with the theory, but globally,
21 where I believe that there is much greater risk in
22 foreign jurisdictions, that the approach of foreign
23 jurisdictions to antitrust competition and

1 intellectual property could impose an obligation to
2 grant licenses, compulsory licensing, and that the
3 U.S. government should make it a priority in -- to
4 other nations on this very issue.

5 COMMISSIONER DELRAHIM: Mr. Osborn and Mr.
6 Cooperman, anything that you'd like to add to that?

7 MR. OSBORN: Well, I would hope that a unilateral
8 decision by a business would not be considered a
9 violation of the antitrust laws.

10 MR. COOPERMAN: I would concur, as well. It
11 seems to me the essence of the patent grant is the
12 right to exclude others, and as long as that is not
13 being abused by misleading parties, inducing them
14 into some understanding, I don't see any reason at
15 all that they shouldn't be denied the right to, or
16 that they shouldn't have the ability to decide
17 unilaterally not to license.

18 COMMISSIONER DELRAHIM: I should also -- I should
19 mention, in the interest of disclosure, my firm does
20 work for Oracle and the medical device manufacturers,
21 which might have some interest in some of the
22 discussions today. Let me ask about the patent
23 settlements, and my time is up, and Mr. Shapiro, you

1 did discuss the issue of weak patents, and the
2 Supreme Court may or may not take up the *Schering*
3 case, they've requested the Solicitor's view, and the
4 FTC has sought *cert* in that case. I think everybody
5 recognizes the potential concerns that private
6 parties might create a monopoly, especially after
7 there has been some kind of a ruling on patent
8 validity at the district court. It's been a practice
9 that no longer continues. However, patent
10 settlements prior to the ruling between parties, and
11 especially where there are reverse payments by the
12 patent owner to the alleged infringer has been
13 questioned. And you mentioned you have concerns
14 about the Eleventh Circuit's ruling. What should be
15 the standard?

16 I mean, how should we presume the strength of
17 intellectual property beforehand, or should we, for
18 the purposes of antitrust law, just presume that it's
19 valid and let the patent system address its validity
20 or its strength or weakness? We should just assume
21 that they're all -- should be valid; there is no
22 relative strength that should be attributed to it for
23 the purposes of antitrust law? However, if a court

1 rules that it's unenforceable or invalid, then, at
2 that time, it would trigger the concerns of the
3 antitrust law; what would be the right mechanism, and
4 who should be in that position to determine the
5 strength of the validity? And we'll start with Mr.
6 Shapiro.

7 PROFESSOR SHAPIRO: I think the presumption of
8 validity -- we should take that to mean that, in
9 order for a defendant in an infringement case to show
10 the patent is invalid, the defendant has to show
11 clear and convincing evidence; that's what the
12 presumption is about. It's not about some assessment
13 of probabilities, okay, as I see it. So whether it's
14 before or after any ruling, I believe I advocate a
15 standard that says a fixed payment, call it a reverse
16 payment if you want, from the patent holder to the
17 alleged infringer in excess of avoided litigation
18 costs should be presumptively anticompetitive, with a
19 pretty strong presumption. And, just simply, because
20 I don't want to go all the way to a *per se* rule,
21 because we don't fully understand these things yet,
22 it seems to me we should be a little open minded, but
23 be presume anticompetitiveness, and the arguments

1 here -- the theory I think is very strong that such
2 payments are, themselves, indicative of weakness by
3 the patent holder, so it does not require a technical
4 assessment or a view on exactly how strong or weak
5 the patent is, we make inferences from the presence
6 of the payment.

7 COMMISSIONER DELRAHIM: Okay. Mr. Osborn, your
8 industry has been affected by this?

9 MR. OSBORN: Yeah, I would -- I feel compelled to
10 say something on behalf of the industry, because we
11 do put an awful lot of time, effort, and money behind
12 not only our research efforts, but also into patent
13 filings that recognize and protect the results of
14 this research; I acknowledge what Professor Shapiro
15 has alluded to in that we have a very significantly
16 overworked and even overwhelmed Patent and Trademark
17 Office, which perhaps results in a lower level of
18 scrutiny of certain patents. However, I believe that
19 reputable firms in our industry are acting in good
20 faith when they prepare and prosecute patents. We
21 employ scientists, we employ patent counsel, we work
22 with outside law firms, and we work to protect for
23 our shareholders the value of our innovation; I

1 reject the notion that we are just throwing things
2 over the transom to see what will be approved. I
3 know that people who focus on this area have proposed
4 a range of reforms. I was at a panel at Harvard Law
5 School a couple of weeks ago in which patent judges
6 at the federal and circuit level were discussing
7 possible reforms that might aid them in evaluating
8 patents, but I would not support changing the
9 presumption in light of the circumstances.

10 COMMISSIONER DELRAHIM: Well, without changing
11 the presumptions, and Mr. Shapiro didn't suggest
12 that, are there costs in addition to avoided
13 litigation costs which would justify --

14 MR. OSBORN: I think there are. It is just a
15 question of two parties in litigation trying to limit
16 uncertainty and risk. Uncertainty in terms of your
17 stock price being held down, because Wall Street
18 analysts want to know how a case will be resolved.
19 There also are costs in terms of business planning
20 and drain of management time. So it's not simply the
21 out-of-pocket costs that relate to payments to
22 lawyers and experts; it's the uncertainty associated
23 with unresolved, lengthy litigation. We happen to

1 have disputes ongoing with respect to two of our
2 products, and so I know from personal experience that
3 there are a lot of other costs that relate to
4 uncertainty and that would perhaps warrant settlement
5 payments in excess of the pure costs of litigation.

6 COMMISSIONER DELRAHIM: Mr. O'Connell, I know
7 that the Solicitor General has been asked for his
8 views, and, therefore, the Antitrust Division, so I
9 will, unless you have something to add, I know you
10 would not want to comment on this.

11 MR. O'CONNELL: I think that's right.

12 COMMISSIONER DELRAHIM: Mr. Morse, and I
13 apologize for going over my allotted time, if we
14 could just get the views of the rest of the panelists
15 on that.

16 MR. MORSE: I've written an article on
17 settlements of patent litigation in the George Mason
18 Law Review. I think the general approach that I've
19 taken there is that the proper question here, as in
20 most of the licensing issues under the intellectual
21 property guidelines is, what would have happened in
22 the absence of the agreement, and that can look to
23 different factual proof. One of the questions is,

1 would there have been another settlement?

2 I'm not sure that it is appropriate, as I think
3 the Commission has in the *Schering-Plough* case, to
4 assume that there would have been another settlement
5 on alternative terms, but in other cases, you know,
6 there may be proof of what would have happened in the
7 absence of the agreement.

8 I do think it's particularly important to draw
9 the distinction between what are sometimes
10 characterized as "partial settlements" and "permanent
11 settlements". The "partial settlement" cases weren't
12 really settlements of litigation at all. The first
13 of the cases the Federal Trade Commission brought in
14 this area were simply agreements that limited
15 competition during the pendency of litigation, and so
16 the argument that there is an efficiency from the
17 settlement of litigation seems to me to be absent in
18 those cases. But in cases such as *Schering-Plough*,
19 where there is splitting of the patent life, it seems
20 to me particularly important, and the agency ought to
21 be focusing on what would have happened in the
22 absence of the agreement.

23 COMMISSIONER DELRAHIM: Professor Gilbert.

1 PROFESSOR GILBERT: Well, a reverse payment can
2 raise a flag, but I'm not sure it does a lot more
3 than that. I mean the problem is, what's a weak
4 patent? We don't know what a weak patent is. You
5 could have a very good patent that gets overturned in
6 court; you could have a poor patent that gets
7 sustained in court. So who knows, really, what there
8 is? It goes back to what -- the uncertainty here is
9 so great. And there are efficiencies from
10 settlements. So I wouldn't take the hard-line view
11 about reverse payments that have been suggested by
12 some.

13 I would like, and I don't know how you'd do this,
14 but there's been certainly a lot of effort to get
15 this message across - that when patents are granted
16 in the first place, there are obvious implications
17 for consumers. If you are granting a patent in an
18 area that really isn't doing much in the way of
19 novelty or what we traditionally associate with the
20 standards for patentability, and similarly, with
21 regard to a settlement, I think courts are
22 conditioned to say that settlements are a good thing,
23 because it's better for the parties to work it out on

1 their own, but of course, a settlement involving a
2 patent can have implications for third parties, the
3 consumers, so the courts need to take that into
4 account. But I wouldn't say that there should be any
5 *per se* rules in this area.

6 COMMISSIONER DELRAHIM: Finally Mr. --

7 MR. COOPERMAN: I think I'm in the same camp as
8 Rich. I mean, I don't think we ought to draw any
9 inferences from the making of a reverse payment, you
10 know, particularly in the software industry where the
11 standards for patenting have been called into
12 question, and the resources of the Patent Office to
13 review prior art have been called into question, just
14 the capability of the staff to marshal their
15 attention at the time of granting patents, I think
16 that's the issue we need to address.

17 And I think we ought to be sure that when patents
18 are granted, the patent is entitled to the
19 presumption of validity, and to the extent that there
20 is some type of a payment, there are many good
21 reasons to justify it. We've talked about the
22 uncertainty here, and I think that's absolutely
23 correct. There's also the involvement of senior

1 management or senior technical staff in the
2 litigation resulting from the patent and their
3 inability then to participate in other activities of
4 the corporation, which is an enormous potential loss.
5 So there are lots of good reasons that, given the
6 uncertainty, and you know, the litigation risk and
7 management time, there might be payments that would
8 exceed strictly the cost of the proceeding itself.

9 COMMISSIONER DELRAHIM: Thank you.

10 CHAIRPERSON GARZA: Okay, thank you. The
11 witnesses have done a good job in their papers of
12 discussing the theoretical and empirical basis for
13 concern about the effects of mergers or other former
14 collaboration on incentives to innovate and the
15 predictive challenges facing the courts and
16 enforcers.

17 I'd like to get the panelists view on how well
18 the current federal enforcement -- how well this
19 current federal enforcement at the DOJ and the FTC
20 correspond with what we presently know about theory,
21 data, and the complexities, and do the agencies'
22 guidelines provide adequate guidance on what their
23 enforcement policies are?

1 And if you could, in addressing that question,
2 perhaps consider the issue of whether or not you
3 think the agencies are giving appropriate weight in
4 evaluating mergers and other forms of collaboration
5 to innovation synergies, whether you think that the
6 Merger Guidelines' unilateral effects analysis
7 accurately describes the analysis used by the
8 agencies in those cases where there have been
9 concerns specifically about alleged innovation
10 effects, and how the standards articulated in the
11 collaboration guidelines and IP Guidelines come into
12 play in the agencies' merger analysis. Professor
13 Shapiro, would you like to start?

14 PROFESSOR SHAPIRO: Sure, I'd be happy to start.
15 I think the guidelines, it's already been pointed
16 out, really do dwell on pricing and hardly talk about
17 innovation effects and how they'll be analyzed at
18 all. So I'm actually pretty open to the idea that's
19 been -- that I think Howard Morse suggested, that
20 some addition to the guidelines, some amendments
21 along these lines would be useful.

22 I think focusing on unilateral as opposed to
23 coordinated effects, but we're not talking about

1 pricing; we're talking about product introduction,
2 R&D efforts, both sides of it -- how do they think
3 about anticompetitive effects, and what sort of
4 factors would be most convincing or not convincing
5 regarding synergies and efficiencies? I think there
6 is sort of practice that people who do this in and
7 out know about, but really, you can't tell from the
8 Guidelines. So there could be some important
9 guidance for the business community in that respect.

10 I don't sense that things are out of whack; I
11 think it varies a lot from one case to the other and
12 depends on the staff, and that's the sort of area
13 where guidelines might be pretty helpful. I just did
14 a -- was involved in a software merger where the
15 concern at the agency was very much about innovation
16 rather than pricing effects, whether new products
17 would be introduced in a timely manner, and whether
18 as much time would be spent with software engineers
19 developing them, and I thought the staff was
20 receptive to what I thought were sort of sound
21 economic arguments about that, but we couldn't really
22 point to the guidelines very specifically to help us.

23 CHAIRPERSON GARZA: Thank you.

1 PROFESSOR GILBERT: If I could follow up on that,
2 I'd agree that some amendments to the guidelines,
3 particularly to the IP Guidelines, would be useful,
4 because we know a lot more now than we did ten years
5 ago, certainly about things like patent pools,
6 complementary products, network effects, areas where
7 I think more guidance could be given, but I also
8 agree; I think the agencies have been doing a fairly
9 responsible job in applying the concepts that are
10 known.

11 CHAIRPERSON GARZA: Thank you. Any other
12 witnesses have any comments?

13 MR. O'CONNELL: I would like to say that I think,
14 generally speaking, the Guidelines set out -- the
15 Merger Guidelines, all the agencies' guidelines -- a
16 flexible, analytical process, but that is all that
17 they lay out; they're not meant to address every
18 possible theory or even every way of looking at a
19 merger. They instead set up a framework within which
20 the agencies, based on the facts that they have in
21 front of them in a particular transaction, can -- a
22 process that they can follow in assessing the likely
23 impact of a transaction. The Division doesn't

1 believe that the Guidelines need to be amended to
2 reflect or address additional theories, because we
3 believe that those theories are already incorporated
4 where appropriate in the analysis that we conduct.

5 CHAIRPERSON GARZA: Can I ask Mr. Osborn and Mr.
6 Cooperman, as our representatives of industry and
7 representing companies that have been through the
8 merger analysis at the FTC and the DOJ, do you have
9 any comments in response to my question?

10 MR. OSBORN: Well, of course my testimony focused
11 on my recent experience with the FTC. It's just one
12 anecdote; it may or may not be fairly reflective of
13 how things work across the board, but as I've said
14 today, my observation was that there should have been
15 more weight given to innovation in the broader sense
16 of the word, that mergers can support the fostering
17 of further product development and more effective
18 commercialization in bringing products to consumers.
19 So perhaps guidelines that would address that point
20 could change the perspective that is brought to bear
21 in an individual merger proposal.

22 CHAIRPERSON GARZA: Mr. Cooperman, do you have
23 anything to add?

1 MR. COOPERMAN: Just that I think it has been a
2 while since the guidelines were issued, and I think
3 it probably would be worth while to take a look to
4 see whether or not some of the features that have
5 emerged over the last ten years or so have been
6 appropriately considered within the guidelines. I
7 think in our industry, for example, the concept of
8 network economies is such a pervasive consideration,
9 and I think, you know, some specific attention there
10 would be warranted.

11 CHAIRPERSON GARZA: Thank you. Commissioner
12 Jacobson.

13 COMMISSIONER JACOBSON: Thank you. Again, just
14 thoroughly excellent presentations, both written and
15 oral, and I know all the Commissioners are extremely
16 grateful. I just want to focus on one limited set of
17 questions, which I mentioned before the hearing today
18 to Professor Gilbert, and I'm going to start with
19 Professor Gilbert. What is the state of the
20 empirical evidence today on the Schumpeter versus
21 Arrow debate about whether a monopoly or competition
22 is more conducive to innovation?

23 PROFESSOR GILBERT: Well, there have been many,

1 many studies that have been done. I would say 20,
2 30, 40 studies, serious studies, empirical studies of
3 the relationship between competition and R&D. And
4 certainly the vast majority of them have come to the
5 conclusion that competitive markets tend to be
6 associated with -- they either come to the conclusion
7 that competition is good for innovation, or some of
8 the studies that have used a lot of controls for
9 different industry circumstances have found no
10 effects at all. There's also been some work showing
11 that, in certain types of innovations where
12 appropriation is very difficult, concentrated market
13 structures have been more innovative. But those
14 results rely on either process innovations or other
15 types of innovations where appropriation is very
16 difficult. Most of the results, I would say, are
17 either neutral or favor competition for innovation.

18 COMMISSIONER JACOBSON: Professor Shapiro.

19 PROFESSOR SHAPIRO: Well, I've conducted my own
20 empirical study, which has consisted of reading
21 strategy documents from dozens and dozens of
22 companies associated with the mergers, okay. This is
23 a highly systematic, quantitative, econometric

1 exercise, I assure you. (I'm joking about that.)
2 And it is very plain to me, and I think, by the way,
3 the testimony, for example, of the FTC hearings on
4 innovation some years ago now showed the same thing,
5 that, you know, basically all of these companies, in
6 all the industries we're talking about here -- it's
7 like, "What are the other guys doing? Is somebody
8 going to come up with something new and eat our
9 lunch? I mean, we better get to work on this, you
10 know? They hired somebody; they're working on this
11 project; we've got intelligence." You know, and
12 that's the fear; that's the motivator.

13 Fear is a powerful force, and so I have no doubt
14 in my mind, based on this study, as I am calling it,
15 that competition in that sense is a very, very
16 powerful force to innovate. Now, in practice, does
17 that mean a four-to-three merger among, you know,
18 companies who are doing software in a particular
19 category is going to be anticompetitive because we've
20 reduced competition? No, of course not. If there
21 are still a couple of players in there who are -- the
22 merging entity is going to be very afraid of some
23 threats from the outside; the fear can stay plenty

1 high, and innovation can stay up.

2 COMMISSIONER JACOBSON: A question for Professor
3 Gilbert, I guess, since he's not relying on Shapiro's
4 life experience, but rather on --

5 PROFESSOR GILBERT: I always rely on --

6 COMMISSIONER JACOBSON: What are the best sources
7 for us to go to to get the highest level of learning
8 on the current state of the empirical debate?

9 PROFESSOR GILBERT: Well, thank you for that
10 question, because I did supply -- I just recently --
11 I don't want to say it's the very best source, but I
12 did just write a survey of competition and R&D for
13 the National Bureau of Economic Research, and it's a
14 long survey, I supplied that as part of my testimony,
15 not assuming that everybody would read it, but it was
16 my attempt to summarize the state of knowledge in
17 that area.

18 COMMISSIONER JACOBSON: I have nothing further.

19 CHAIRPERSON GARZA: Okay, thank you.

20 Commissioner Kempf.

21 COMMISSIONER KEMPF: Let me start with something
22 and make a comment and see if anybody has any
23 questions. There's a fair amount of discussion in

1 the various submissions about dynamic analysis versus
2 static analysis. My own view is that it's been clear
3 since at least the *General Dynamics* case that it's
4 only a dynamic analysis that counts and that a static
5 analysis is only relevant in an industry where the
6 static -- the industry itself is static, or, to state
7 it differently, where the dynamic and static analyses
8 are the same. And the problem occurs because so much
9 of the data we have to look at is backward-looking
10 rather than forward-looking. Market shares are by
11 definition backward-looking.

12 And the *General Dynamics* case sought to reconcile
13 those drawing on *Brown Shoe* with the statement that,
14 of course, they're a great starting point, but only,
15 I think, are the words they used, a further analysis
16 of all the relevant factors counts, and you have to
17 start somewhere, so I'm not troubled by the fact that
18 you start with static data. But the discussion that,
19 gee, there should be more dynamic analysis thing I
20 think is settled by *General Dynamics*. Does anybody
21 have a quarrel with that?

22 [No responses]

23 Okay.

1 The guidelines themselves grew out of a couple of
2 decisions in the mid '60s, where, as Justice Stewart
3 I think was famously observed, "The sole consistency
4 that I find is that"... "the government always wins."
5 And the business community said, "Geez, you know, we
6 spent a lot of money to do all this stuff, and it's a
7 crap shoot; we need some guidance." But I have never
8 viewed them as a proxy for what the law is or should
9 be.

10 Obviously, there's a closeness to them, but not
11 an identity, in my judgment. And I have always
12 thought that they provided a sensible approach for
13 the business community to know what, as a starting
14 proposition, the government was likely to scrutinize
15 closely and perhaps challenge that it was always open
16 for merging parties to come in and say, "Gee, you
17 shouldn't do this," and whether it's a two-year test
18 or a five-percent test or anything else, those were
19 always benchmarks for enforcement likelihood, not for
20 illegality, and it was always open for someone to
21 come in and say, "Gee, to build a widget plane, it
22 always takes three years." They'll start building
23 them immediately, but they won't be open until the

1 third year. Yet the impact will be felt immediately,
2 because there will be holes in the ground and widget
3 plants going up. And my question is, does anybody
4 have any comment on that?

5 PROFESSOR GILBERT: I'd like to say a little bit
6 about that. I mean, merger analysis is always
7 forward-looking; it has to be by definition. And we
8 try to look for competitive conditions that are going
9 to say something about the future, whether it's in
10 the near term or a couple of years out. Innovation
11 analysis is clearly an attempt to do that.

12 And I'd like to take the opportunity to say
13 something about innovation-market analysis. It's
14 very much -- I think it's very much like product-
15 market definition in that no one assumes that
16 defining a product market is going to tell you the
17 answer as to whether or not prices are going to go up
18 or go down; at least that's not the conventional
19 economic wisdom today. And the same with an
20 innovation-market approach; that doesn't tell you
21 whether innovation is going to go up or go down; it's
22 just a screen, just like a product market is a screen
23 to identify areas where you don't expect prices to be

1 affected by a transaction. Once you've identified
2 those transactions where you could either have price
3 effects or innovation effects, that's when the hard
4 work starts; that's when you have to actually see,
5 are the conditions going to favor innovation, or
6 discourage innovation, or result in a price increase
7 or not result in a price increase?

8 And certainly my view is that an innovation
9 analysis could very well lead to a conclusion that a
10 transaction is going to promote innovation even
11 though it may have some price impacts, even if it
12 might have some undesirable price impacts. Or the
13 opposite could be true; you could reach the
14 conclusion that a transaction would harm innovation.
15 But it's not the product market analysis, or it's not
16 the innovation market analysis that gets you there;
17 that's just the first step in the real analysis.

18 COMMISSIONER KEMPF: Let me follow up on that.
19 As I read the papers, essentially everybody agrees
20 that innovation is important, and in reviewing
21 transaction likely competitive effects, it is
22 important to consider what its impact will be on
23 innovation. My question goes from that to this: I

1 can see that in, how will this impact innovation on
2 widgets, or whatever the product is. But what about
3 innovation as its own separate self-contained market,
4 saying, "Well, I'm not talking about innovation in
5 widgets; I'm talking about innovation as innovation,
6 and I'm having a separate market for innovation"?

7 PROFESSOR GILBERT: Yes, I think innovation
8 markets are useful in that instance, because if you
9 know exactly what's going to happen, or you have a
10 very good idea of the probability of developing a
11 particular type of widget, you can use the potential-
12 competition type approach to evaluate the competitive
13 effects of a transaction.

14 I think innovation markets are particularly
15 useful when you have a situation where you know
16 people are doing R&D in an area that everyone agrees
17 is very important. I use the example of gene
18 transplants to treat macular degeneration of the
19 retina; there are no products to do that yet, but
20 people are working in that area.

21 So you can't use the potential competition
22 analysis because potential competition assumes you
23 have a product market in which competition would be

1 affected. Here you have innovation in a very
2 important area that's likely to lead to something, so
3 you care very much about whether innovation is going
4 to be promoted or retarded in that area, and I think
5 an innovation analysis is appropriate for that type
6 of situation.

7 COMMISSIONER KEMPF: Anybody want to comment,
8 particularly someone who might disagree?

9 MR. MORSE: Well, I want to disagree not with
10 that point, but with part of I think your previous
11 question. On that point, to be honest, I am in
12 agreement with Rich on innovation markets,
13 particularly drawing attention to the issue of the
14 pace of innovation and not just the price in the
15 future market, and that focus on the pace of
16 innovation is important. But I also wanted to
17 address your question regarding the Guidelines.

18 I think it would be a mistake to understate the
19 importance of the Merger Guidelines, not only in
20 counseling, where it's important, but also in
21 litigation. I think that there are any number of
22 cases in the last 10 or 15 years where courts have
23 relied on what the government has said in the

1 government's Merger Guidelines, and I think that's
2 generally positive.

3 I think the Merger Guidelines have been
4 particularly successful because they are based on a
5 lot of experience in looking at mergers, not just a
6 bunch of theoretical policy folks sitting in the back
7 room, but the government actually writing its
8 guidelines to catch up with what they've been doing
9 over the years. But the Guidelines are also
10 important to us in helping our clients to understand
11 the government thinking. It is a wonderful
12 educational tool for the business community, as well.

13 COMMISSIONER KEMPF: Carl.

14 PROFESSOR SHAPIRO: I think the innovation-market
15 analysis should really be rooted in what's going to
16 happen in future product markets, and that's an
17 important discipline. Take a Defense Department
18 merger; so maybe there are only two or three
19 companies who the DOD thinks are really in a position
20 to develop the next-generation fighter jet or
21 helicopter, whatever; it's fine to say, "Well, these
22 are the companies we think have the capabilities or
23 are doing the R&D," perhaps in that case paid for by

1 DOD, but ultimately they're saying, "Six years from
2 now, when we think we're going to have the next
3 procurement, we don't want to lose one of these; we
4 want them two or three or whatever number to be
5 there; we need and want the competition in the
6 future."

7 So with that discipline, I think, you know,
8 looking at current capabilities is fine if you really
9 know who -- can identify who has those capabilities,
10 which is an important discipline, as well.

11 CHAIRPERSON GARZA: Okay. Commissioner
12 Valentine.

13 COMMISSIONER VALENTINE: Thank you. Since I come
14 late in the line here, I am going to actually ask a
15 question more related to the subject matter of our
16 next panel, and if you don't feel prepared to answer,
17 would prefer to think about it and submit written
18 comments, that's fine too. One of our panelists this
19 afternoon has suggested that, with respect to
20 litigation, there be a proposed amendment to the
21 injunctive relief section of the Patent Act, which
22 essentially allows court to issue injunctions
23 consistent with principles of equity, and he proposes

1 the following amendment: "In determining the right to
2 injunctive relief of a patent owner who does not
3 participate in the market for a patented invention
4 against an infringer who did not act", and I think he
5 means to say willfully or intentionally or knowingly,
6 "copy the invention from the patentee or otherwise
7 act willfully, the court shall consider, where
8 relevant and among other factors, the portion of the
9 defendant's product that constitutes the inventive
10 contribution as distinguished from other features of
11 the product or improvements added by the infringer."
12 I'd like to know peoples' thoughts on this proposed
13 modification. Rich, you look ready to answer.

14 PROFESSOR GILBERT: Well, I did read the
15 testimony, so I had a chance to think about it.
16 Certainly, it addresses -- we have many industries,
17 semi-conductors are a good example, where a
18 particular product can be covered by just thousands
19 of pieces of intellectual property, whether it's
20 patents or copyrights or trade secrets or whatever.
21 And someone can pop up and have one tiny little
22 piece, and that can be the basis of an injunction
23 against the whole product.

1 And that piece, the actual contribution of that
2 piece, could be very, very small, and yet it can --
3 it's kind of like the last person to agree to sell
4 some land to build a freeway, can get the whole value
5 of the freeway. So I think it's a sensible policy
6 recommendation to have some kind of apportionment.
7 There might be other approaches, maybe allowing
8 royalties with some multiple and denying injunctive
9 relief all together. Another possibility would be to
10 make damages, allow a defense in damages to include
11 some measure of the invent around costs, because
12 there are some circumstances where you can get
13 millions and millions of dollars worth of damages for
14 a technology that could have been invented for around
15 \$100, and so that is -- I find could be another way
16 of doing this.

17 I think one of the important issues raised by
18 that proposal is that many of the problems of the
19 patent regime that face so many industries today I
20 think could be addressed, if not solved, but at least
21 addressed, by thinking about redesigning damages and
22 how we think about damages, rather than having to go
23 back and rewrite the patent laws.

1 COMMISSIONER VALENTINE: Okay. Carl.

2 PROFESSOR SHAPIRO: I'm very tempted to want to
3 support that, because I think problems of hold-up
4 patent thickets are very real. However, we just --
5 everybody just agreed that a unilateral unconditional
6 refusal to license was not an antitrust violation at
7 least, and I'm concerned; how are we going to figure
8 out -- now you're going to have a permanent mandatory
9 licensing regime, I guess, for these -- in a
10 situation; if there's no injunction issued, there's
11 going to be some royalties I guess that will have to
12 be paid; somebody is going to have to figure out what
13 those are. So I find it difficult, but I think maybe
14 a better solution to avoid hold-up is to make sure
15 that the defendants in these patent cases have plenty
16 of time to invent around, so they're not held up, so
17 there will be a lag before imposing the injunction,
18 but eventually the injunction would issue, okay, and
19 then the damages or reasonable royalties should very
20 much recognize this type of thing, the percentage of
21 the product that's the contribution to the patented
22 invention; if it's one slice, we should have much
23 smaller reasonable royalties. But eventually I think

1 the right has to be reasserted, as much as I hate to
2 say that, but I think you can avoid hold-up by giving
3 time before the injunction enters.

4 COMMISSIONER VALENTINE: Got you. Mr. Morse.

5 MR. MORSE: I share Carl's concerns. I just want
6 to point the Commission to the fact that this issue,
7 the patent, what's sometimes called the patent-
8 control issue, and the kind of provision you're
9 talking about was in some proposed legislation, I
10 believe, earlier this year. I think the patent
11 reform --

12 COMMISSIONER VALENTINE: That's hopefully
13 described in the testimony; don't worry.

14 MR. MORSE: -- is going -- has been debated on
15 the Hill, and that, as I understand it, the lead
16 legislation has dropped --

17 COMMISSIONER VALENTINE: That's all -- we've got
18 all that before us. Thank you. One more quick
19 question; I thought that I was essentially hearing
20 from all of the witnesses, you know, plus or minus a
21 little, that we shouldn't have new rules for high-
22 tech industries, and that the antitrust laws that
23 we've got out there work pretty well, except for the

1 timing, and we obviously do all sympathize with Mr.
2 Cooperman, and I fully endorse his proposal and think
3 we should do it, except that, possibly, we have two
4 lead agency investigators so we don't get national
5 champions. But in any case, if that's what I was
6 hearing, then how do we square that with the concept
7 that maybe the Merger Guidelines, in fact, don't
8 sufficiently accommodate innovation and we ought to
9 be changing or tweaking the Merger Guidelines to
10 better accommodate innovation? Or what is a specific
11 change to the Merger Guidelines?

12 And I really want pretty specific changes now
13 rather than grandiose thoughts, because somebody has
14 got to write this stuff eventually, that we could
15 make to better accommodate innovation that wouldn't
16 be some kind of special rule, special pleading for
17 high-tech industries? Thoughts, anybody? Rich's
18 hand is up first.

19 PROFESSOR GILBERT: I think the value of writing
20 new Guidelines, whether they're new IP Guidelines or
21 new Merger Guidelines, is not so much to change the
22 way the agencies do business, because I think they do
23 business now by drawing on all the available

1 theoretical and empirical evidence, but rather, the
2 value is, as Howard said, in educating the industry
3 and practitioners about how the agencies might look
4 at a transaction and be useful in that manner,
5 because we do know some things now. I mentioned
6 patent pools, when patent pools are desirable, when
7 they're not desirable, some conditions on patent
8 pools that would make them -- that provide safeguards
9 against antitrust violations, the issue of pricing
10 complementary products, when that is beneficial, and
11 when it's not. We might also add something about
12 what I would call an innovation-market defense for
13 mergers, under what conditions might innovation be --
14 would a reduction in market competition be associated
15 with an enhancement of innovation? So these are
16 things that are in the literature, both in theory and
17 empirically, that the agencies know about, so they
18 can apply it, but it's not communicated to the larger
19 universe of people who work in this area, and it
20 could be useful to do that.

21 COMMISSIONER VALENTINE: Carl, Mr. Shapiro.

22 PROFESSOR SHAPIRO: Here are three things you
23 could do, you could -- they could say something about

1 why it would be rare, I think, to have a coordinated
2 effects case involving R&D or innovation. On the
3 unilateral effects side, the second thing, what do we
4 do, since we're not -- if we're looking at product
5 introductions instead of the pricing issues, we
6 presumably would look at how much one -- when one
7 company introduces a product, how much it takes
8 business from the other companies' products, and that
9 would be a central thing to look at, and how that
10 affects, you know, incentives to bring out new
11 products, and how that would be changed by the
12 merger, so articulate how unilateral effects
13 arithmetic and logic would work, and then talk about
14 what would count as a merger-specific R&D efficiency.
15 There are some offsets. If you're combining
16 complementary products, that could be very pro-
17 competitive; will that be offset by potential price
18 increases due to unilateral anticompetitive effects,
19 and how would, you know, combining research synergies
20 be evaluated? Those things could be articulated.
21 I'll give you language this afternoon.

22 COMMISSIONER VALENTINE: Thank you. Anyone else?

23 MR. OSBORN: Well, I think it's a good question.

1 The frustration that I felt as I went through the
2 process, though, probably had more to do with sort of
3 a cultural perspective. I'm struggling a little bit
4 to come up with specific language. I guess it would
5 perhaps be along the lines that Carl suggested, that
6 at least as to pharmaceuticals and biotechnology,
7 there might be some specific consideration given to
8 the ability of the acquired company to further
9 develop and effectively market the product, as
10 opposed to a more focused analysis that relates
11 purely to potential entry and effect on price.

12 COMMISSIONER VALENTINE: I'll ask you later who
13 your outside counsel were and who the staffers were.
14 I better pass my time.

15 CHAIRPERSON GARZA: Okay. Commissioner
16 Burchfield.

17 COMMISSIONER BURCHFIELD: Thank you, thank you
18 all. To all the panelists, this has been a very
19 insightful discussion. I want to start by going to
20 Mr. Cooperman. You have tabled a proposal that is
21 drawing universal praise apparently from the panel
22 and from many of our Commissioners. I want to ask
23 you, though, about one statement in your written

1 statement, and that is, you stated on page four, that
2 the fragmentation and the resulting confusion related
3 to international reviews of antitrust far exceeds the
4 similar problems often observed as a result of the
5 parallel antitrust jurisdiction shared by the federal
6 government and the 50 states.

7 And I wanted to ask the other panelists,
8 particularly Mr. Morse, in your private practice
9 capacity, and Mr. Osborn, in your capacity as in-
10 house counsel who deals with at least potentially the
11 international agencies, whether you have also found
12 the international issues of coordination to be far
13 more problematic than the issues of coordination
14 among the states?

15 MR. OSBORN: I can answer briefly. We have
16 completed acquisitions in Europe and in the United
17 States, but they have tended to be of a far more
18 limited scope than those that Oracle is engaged in,
19 and so perhaps we had occasion to deal with
20 authorities in Belgium and France, but not, in that
21 case, the United States agencies, let alone 25 other
22 countries, so our experience simply isn't as vast.

23 COMMISSIONER BURCHFIELD: Mr. Morse.

1 MR. MORSE: Well, on the merger front, there's no
2 question that the number of jurisdictions reviewing
3 mergers creates difficulties, but we deal in a world
4 of sovereign governments, and so the question is how
5 we solve the problem, and I do believe that my sense
6 that the ICN process has been a positive one, that
7 the ICN has developed best practices for
8 jurisdictional review and has made some of those
9 countries that appeared on all of our charts -- you
10 know, well, why is it that we're having to file in
11 country X? Some of those countries have moved off of
12 that list. So there has been progress, and I think,
13 to the extent that Mr. Cooperman is urging --

14 COMMISSIONER BURCHFIELD: How do you compare
15 that, though, to the experiences you've had
16 domestically with the states reviewing mergers?

17 MR. MORSE: I have not had a lot of personal
18 experience. I think that the states have jumped in
19 on only a small number of mergers other than those
20 that are particularly local where they do jump in.
21 Obviously, they have got involved in some mergers
22 that we think have national impact, I don't have much
23 personal experience there. I have had experience

1 with the states on some of the other issues that
2 we've talked about, and I'm not sure that the states
3 are all on the same page as the federal government on
4 some of the issues such as unilateral refusals to
5 license. I am hopeful that that is a question of
6 educating the states so that they end up in the same
7 position.

8 COMMISSIONER BURCHFIELD: Let me ask, turn to Mr.
9 Osborn, for what may very well be my last question,
10 and that is, you referred in your statement to the
11 particular situation you had in a merger your company
12 was trying to complete in which one of the important
13 assets was technology that your company would have
14 been better able to commercialize than the target
15 company, and the question that I would ask you is,
16 and then I would also like Mr. O'Connell's view on
17 it, is, to what degree is the ability of the
18 developing company to license that technology, as
19 opposed to allow itself to be a merger candidate,
20 relevant, or should it be relevant to the analysis of
21 the antitrust agencies as they review a merger?

22 MR. OSBORN: Well, it's my understanding that
23 exclusive-license arrangements are subject to Hart-

1 Scott-Rodino review, so I suppose that would be your
2 starting point. Whether or not a transaction is
3 structured as a license or as an acquisition, I'm not
4 sure it really affects the analysis that we're
5 talking about here today. I mean there are a lot of
6 business reasons to why a firm might want to
7 restructure a deal as an acquisition rather than as a
8 licensing transaction.

9 The transaction that I did not mention in my
10 written testimony, but I alluded to it in my brief
11 opening statement, was a two-part transaction in
12 which we initially licensed a product from a smaller
13 company in France, took it through clinical
14 development, received FDA approval, did additional
15 studies, received a number of additional indications
16 for it, and along the way, ended up acquiring the
17 company because their CFO decided that it was time
18 for him to sell the firm. And so whether that
19 analysis would have changed early on, certainly the
20 product was more valuable and more developed at the
21 time we completed the acquisition, but I don't think
22 that particularly mattered.

23 COMMISSIONER BURCHFIELD: Well, hypothetically,

1 you can envision a situation in which a developing
2 company is one of the cutting-edge thought leaders in
3 an industry, and there might be some concern, maybe
4 there isn't, that the acquisition of the company
5 might have an adverse effect on further development,
6 whereas the licensing of the particular invention
7 might allow commercialization of that product, as
8 well as continued development.

9 MR. OSBORN: We would have been delighted to have
10 either acquired or in-licensed the OraVescent
11 Fentanyl product from CIMA Labs, but the CIMA Labs
12 shareholders and their board wouldn't have been
13 delighted to do that deal.

14 COMMISSIONER BURCHFIELD: From the Justice
15 Department's perspective, Mr. O'Connell, can you
16 comment on the role, the alternative an exclusive
17 license might play in the sort of situation that Mr.
18 Osborn has described?

19 MR. O'CONNELL: I guess if I could ask for a
20 clarification; is the question whether we would have
21 a view one way or the other way if it were an
22 exclusive license as opposed to an outright merger?

23 COMMISSIONER BURCHFIELD: That's correct.

1 MR. O'CONNELL: I think -- well, it would depend
2 I think on the facts of the case that we had in front
3 of us. I think the question that we would have to
4 address in either case is, what's the likely effect
5 of the proposed transaction, whether it be an
6 exclusive license or a merger, on the market, on
7 competition down the road, and I could easily see
8 facts where either could be a problem, where neither
9 could be a problem. It's certainly something that we
10 look at frequently. But the structure of the
11 transaction is less important than its effect on
12 competition.

13 COMMISSIONER BURCHFIELD: Okay, thank you.

14 CHAIRPERSON GARZA: Commissioner Yarowsky.

15 COMMISSIONER YAROWSKY: Okay. I'll wrap this up
16 just with two questions, and that will be the
17 morning. The first one, to Mr. Osborn. I understand
18 your point that, in some industries, mergers and
19 acquisitions may be absolutely indispensable. I
20 mean, you can commercialize quicker, you can maybe
21 develop a uniform offering nationally, all the things
22 that maybe some small start-up companies can't do.
23 Let's say that's the case in a certain situation.

1 But let's say, in effect, that acquisition is
2 that intergenerational change. The pace of
3 generational change in that particular industry
4 doesn't have to be the pharmaceutical or biolife
5 industry, but whatever industry we're talking about
6 would slow down, would slow down because, let's say,
7 the smaller company was a disruptive -- company that
8 kept, you know, whose whole -- was to, every 18
9 months, move forward, move forward. Let's say, after
10 the acquisition occurred, that pace slowed down, not
11 necessarily for any nefarious reason or conscience
12 reason; it just slowed down. How would one balance
13 those effects competitively in that kind of
14 situation?

15 MR. OSBORN: Well, first of all, I didn't mean to
16 suggest that you wouldn't necessarily wish to take
17 into account factors other than the ones I
18 highlighted. I am simply suggesting that I see an
19 imbalance and a lack of appreciation for what you've
20 set out.

21 Again, just from a practical business
22 perspective, what I would observe is that it's just a
23 very dynamic business. Even if you were to take it

1 down to the level of an individual acquisition,
2 people often don't stay with the firm after the
3 acquisition. You acquire the assets of a firm; some
4 of the folks stay, but many of them leave.

5 People who have the kind of character and
6 perspective and entrepreneurial capacity for risk,
7 that's what they want to contrive to do; so they're
8 going to go out and do other things. That's why
9 there are always thousands of these companies at any
10 given time, but they're always different. So in the
11 aggregate, I don't think you would likely lose much,
12 although again, I wouldn't say you shouldn't think
13 about those issues in the course of evaluating a
14 given transaction.

15 COMMISSIONER YAROWSKY: Any other comments?

16 PROFESSOR SHAPIRO: A quick comment; I mean take
17 the case you've got a developing company, and they've
18 got this great product, but they're not in a position
19 to commercialize it, and then there's the incumbent
20 product, which is the main one that they will be
21 taking business away from, wants to buy them. You
22 could say, well, look, the little guy is not going to
23 commercialize it on his own, so, you know, what's the

1 harm? But look, you probably look at those
2 documents, and the little company says, "Well, we'd
3 love to sell it to these guys if they pay enough, but
4 if we don't sell to them, we're going to have another
5 strategy for getting to market," and it seems to me
6 it would be sort of silly not to consider that in
7 figuring out the genuine effects of the proposed
8 transaction.

9 COMMISSIONER YAROWSKY: Last question, and this I
10 think is going to draw from Commissioners Jacobson's
11 and Valentine's attempts to try to see how to -- some
12 of these issues. What more needs to be done, both
13 empirically and analytically, to bring innovation to
14 the Merger Guidelines? I may learn this after Carl
15 jots some things down at lunch, but let me just say
16 why I rephrase that question one more time. We've
17 heard that the Merger Guidelines of '97 hardly
18 mention innovation. This really amazing survey that
19 you just took us into, Professor Gilbert, even in
20 your written testimony, really shows a rich, diverse
21 set of empirical research findings that are often
22 based on industry circumstances and other variables,
23 but there's certainly not a unified field theory.

1 Unfortunately, for public officials who make policy
2 in at least two branches of government, and those are
3 probably the only two that should be making policy,
4 you almost need a unified field theory or at least
5 some well accepted finding so that someone then will
6 sit down and write something in a guideline or in a
7 statute so that a judge, if it ever reached the
8 judicial level, would be able to apply it.

9 In no way to take away from the amazing field of
10 innovation, we are not quite there yet, with all the
11 work that's gone on, to be able to take that next
12 step, not that that's the most important step.
13 Research is important in and of itself, but to take
14 the next step to the policy-making level -- I think
15 that's why -- I heard a couple other Commissioners --
16 that, as well, and that's my last question really.

17 PROFESSOR GILBERT: If I can respond.

18 COMMISSIONER YAROWSKY: Yes, absolutely.

19 PROFESSOR GILBERT: We aren't quite there yet.
20 People have been working hard on innovation and its
21 relationship to competition for over 50 years, and
22 just the paper count in this area is staggering. I
23 keep reading this literature, and every time I read

1 it, I find another paper that has been written in
2 this area that I should read. I think it's
3 unrealistic to expect that we will ever have a
4 unified theory, but I don't think that means we
5 should disregard this issue. We don't really have a
6 unified theory of the relationship between market
7 structure and prices either, because there are lots
8 of things that can happen there as well. What we
9 will have is a better understanding, I think, of when
10 innovation is likely to be a concern in a merger case
11 or in a Section 2 case and when it's not going to be
12 a concern, but any determination would have to be
13 very highly fact specific, look at the record in the
14 case, and bring in individual circumstances. I don't
15 think we'll ever be able to have a "simple rule" that
16 will give us the answer.

17 COMMISSIONER YAROWSKY: And I want to hear
18 others, but do you think we'll ever reach the point
19 of being able to weigh these factors, that without
20 have a unified field theory, kind of the next step
21 down would be, if there was a way to judge them,
22 balance them, and weigh them, so that you actually
23 then could reach a conclusion?

1 PROFESSOR GILBERT: I think we can do that, much
2 as we weigh efficiencies and anticompetitive effects
3 in a rule of reason analysis. I don't think there's
4 any reason we can't also weigh innovation effects if
5 we're fairly confident of them, and we know that
6 these innovation effects can be very -- can be
7 dramatic.

8 COMMISSIONER YAROWSKY: Okay.

9 CHAIRPERSON GARZA: Well, thank you very much to
10 the panelists, again, for both your papers and your
11 testimony here today. And while I'd like to be able
12 to tell you that's the last you'll hear from us, I
13 can't make that promise; it's conceivable that we'll
14 want to follow up with you on certain things. But
15 I'll also tell you that the Commission's doors and
16 windows are open. We have an Internet portal. So if
17 there are any other additional papers or thoughts
18 that you'd like to get to us for us to consider,
19 please feel free to do so. Thank you.

20 MR. HEIMERT: The Commission will adjourn for
21 lunch and resume at 12:45 with the panel on patent
22 reform.

23
24 [Recess.]

1
2 PANEL II

3 CHAIRPERSON GARZA: Thank you very much to
4 the panelists this afternoon for your very thoughtful
5 written testimony and for coming here to subject
6 yourselves to our questions this afternoon. Let me
7 just very quickly go over how we want to proceed.
8 First, I'm going to ask that each of you summarize
9 your written testimony in short, five minute
10 statements. There are boxes on each of the tables
11 with red, green, and yellow lights to help you gauge
12 where you are in that five minutes. We've taken
13 great care to read all of your statements, I can
14 assure you, and we hope to cover the major points in
15 our questioning. So if you could try to keep it to
16 five minutes, we'd appreciate it; it'll leave more
17 time for a discourse between yourselves and the
18 Commissioners.

19 After each of you have given your separate
20 statements, then Commissioner Delrahim will be the
21 lead questioner for the Commission. He'll have about
22 20 minutes to put questions to the panelists, and
23 then we will give each of the other Commissioners
24 about five minutes to ask follow-up questions. So

1 that's how we'll proceed this afternoon. And with
2 that, we usually honor our guests from the government
3 first, and so, who all is that? Susan, it's just
4 Susan now?

5 MS. DeSANTI: We have two government
6 witnesses, so we need a second rule.

7 CHAIRPERSON GARZA: Okay. Well, we're going
8 to put ladies first, so Susan DeSanti, we'll start
9 with you, if you can summarize your written
10 testimony.

11 MS. DeSANTI: Thank you. Thank you for
12 inviting me to join this afternoon's discussion of
13 patent law reform, which is a topic on which the FTC
14 has produced an extensive report. In these brief
15 remarks, I will discuss the FTC's activities in this
16 area. And, rather than delve into the particular
17 details of the FTC's recommendations for patent
18 reform, I'd like to share some of what we heard from
19 business people about how patents operate to promote
20 or deter competition and innovation in their
21 particular industries.

22 This broader context may best illustrate how
23 patent law relates to the work of the Antitrust

1 Modernization Commission. The views I express are my
2 own and do not necessarily represent those of the FTC
3 or any Commissioner, although the Commission has
4 authorized me to appear and provide this statement.

5 Competition and patent law stand out among
6 the federal policies that influence innovation. Both
7 competition and patents can foster innovation. But
8 each requires a proper balance with the other to do
9 so. As antitrust practitioners have learned,
10 overzealous antitrust enforcement, such as that
11 during the 1970's, can undermine the innovation that
12 patents can promote. Conversely, an invalid patent
13 can harm competition. To examine the current balance
14 of competition and patent law in policy, the FTC,
15 together with the Antitrust Division of the
16 Department of Justice, undertook joint hearings in
17 2002. The FTC's report, issued in 2003, discusses
18 and makes recommendations for the patent system to
19 maintain a proper balance with competition law and
20 policy. A second joint report by the FTC and the DOJ
21 will discuss and make recommendations for antitrust
22 to maintain a proper balance with the patent system.
23 We are working with renewed vigor on completing that

1 report.

2 The hearings included testimony from more
3 than 100 written submissions and 300 panelists.
4 Business representatives were mostly from high-tech
5 industries, pharmaceuticals, biotech, computer
6 hardware and software, and the Internet. And
7 hearings participants found much to praise in the
8 current patent system.

9 Nonetheless, many participants in and
10 observers of the patent system expressed significant
11 concerns that, in some ways, the patent system is out
12 of balance with competition policy. A global concern
13 that representatives from each of the four industries
14 described was that poor patent quality can stunt
15 incentives to innovate. A poor quality or
16 questionable patent is one that is likely invalid.
17 Hearing participants raised concerns about the number
18 of questionable patents issued.

19 Questionable patents can deter or raise the
20 cost of innovation. Professor Jonathan Levin of
21 Stanford identified three economic consequences that
22 may flow from issuing patents of questionable
23 validity. First, such patents may slow follow-on

1 innovation by discouraging firms from conducting R&D
2 in an area out of fear that they may be infringing.
3 Second, if a competitor chooses instead to negotiate
4 a license to and pay royalties on the questionable
5 patent, the cost of follow-on innovation and
6 commercial development increases due to unjustified
7 royalties. Third, if instead the patent is
8 challenged in litigation, the ensuing costs are a
9 drain on the system.

10 These three economic consequences are not
11 the only costs associated with questionable patents,
12 however. In some industries, such as computer
13 hardware and software, firms can require access to
14 dozens, hundreds, or even thousands of patents to
15 produce just one commercial product. In industries
16 with such incremental innovation, questionable
17 patents can increase defensive patenting. The need
18 to develop extensive patent portfolios for defensive
19 purposes diverts funding from R&D into the obtaining
20 of patents.

21 In its Report, the FTC made several
22 recommendations for patent law. I will only speak to
23 the last area of the FTC recommendations, a broader

1 policy perspective for patent law. It is this area
2 that might be most fruitful for consideration by the
3 Antitrust Modernization Commission. All of you
4 understand quite well how new economic learning, most
5 generally associated with the Chicago School
6 thinkers, brought an updated economic framework to
7 antitrust that, among other things, emphasized the
8 importance of seeking to understand efficiencies, as
9 well as possible anti-competitive effects associated
10 with particular business conduct. The FTC
11 recommended that patent practitioners similarly
12 expand their consideration of economic learning and
13 competition policy concerns in patent law decision
14 making. The Supreme Court has made clear in several
15 decisions that there is room for policy-oriented
16 interpretation of the patent laws. Indeed, to find
17 the proper balance between patent and competition
18 law, the FTC stated such policy-oriented
19 interpretations are essential.

20 Finally, the statute that created the AMC
21 charges it with examining whether the need exists to
22 modernize the antitrust laws and to identify and
23 study related issues, among other things. Antitrust

1 law protects competition and the competitive process
2 by preventing certain types of conduct that threaten
3 a free market.

4 For the last 20 years, antitrust law has
5 recognized enhancing consumer welfare as the single
6 unifying goal of competition policy. Antitrust's
7 focus on consumer welfare reveals that governmental
8 impediments to competition can be as harmful to
9 consumers as private business restraints. As
10 illustrated by a wide variety of business testimony,
11 the prevalence of poor quality patents is an
12 impediment to competition, and it is an impediment
13 that by definition is governmentally created and,
14 like private business restraints, harms consumer
15 welfare. The AMC may wish to consider the issue of
16 patent law reform in this context. Thank you for
17 this opportunity to speak, and I'll be happy to
18 respond to questions at the appropriate time.

19 CHAIRPERSON GARZA: Thank you. Mr. Pinkos.

20 MR. PINKOS: Thank you very much, and it's a
21 pleasure to be with you all today, and it's wonderful
22 to see the Commission in action. I had the
23 opportunity, in my former life as a staffer to the

1 House Judiciary Committee, to help work on the
2 legislation establishing the Commission, and actually
3 the greater battle was getting the funding for the
4 Commission so it could actually operate.

5 I never thought at the time that I would
6 necessarily be speaking with you all in this
7 capacity, but circumstances change. So it's really
8 good to be here and to have an opportunity to talk
9 with you all about America's intellectual property
10 system and the issue of patent reform as part of your
11 broader effort to make recommendations on antitrust
12 law modernization.

13 I want to emphasize that the U.S. Patent and
14 Trademark Office wholeheartedly affirms and supports
15 the underlying principles of America's system of IP
16 protection. These principles have helped propel us
17 from a nation that we all know as a small agrarian
18 society to the world's preeminent technological and
19 economic superpower, and as evidenced by Article One,
20 Section Eight, Clause Eight to the Constitution, our
21 founders understood that a property interest granted
22 to inventors for a limited period of time would
23 create an incentive for innovation and competition.

1 And we've seen for more than 220 years the economic
2 success story that that has spawned, and our nation
3 has remained committed to and clearly prospered from
4 the vision of our founders. You may have learned
5 through some other testimony that you received that
6 IP-based enterprises make up the largest sector of
7 the U.S. economy, and that a recent study came out
8 showing that its worth is between \$5 trillion and
9 \$5.5 trillion dollars, which is about 45 percent of
10 our GDP.

11 And IP-based industries, including
12 entertainment, information technology, and
13 biotechnology, are our nation's number one export,
14 and they continue to need the protection that our
15 intellectual property system provides. And some, of
16 course, talk about the tension between intellectual
17 property law and antitrust law, and I think,
18 oftentimes, this arises from the belief among some
19 that patents are a form of a monopoly, and I think
20 that, again, it depends on how you define "monopoly."

21 But a patent allows an inventor to exclude
22 others from using or selling the invention without
23 their permission, but it's not really, in our view, a

1 monopoly in the antitrust sense. That's because, in
2 exchange for receiving a limited grant, inventors
3 must fully disclose their inventions in 18 months for
4 all the world to see, study, and improve upon. And,
5 looking across the world, what we consistently see is
6 a high correlation between a country's economic
7 strength and the vitality of its patent system. And,
8 of course, there are many factors that weigh into
9 that, but it's no coincidence that the U.S. stands at
10 the top of the list of the most successful economic
11 countries, with also the most vibrant intellectual
12 property system. Now, of course, the USPTO is
13 uniquely situated in the U.S. government as the one
14 agency that solely focuses on IP, whether it's on our
15 business side of things, examining patents and
16 trademark applications, or on the policy side. So,
17 we very much welcome the viewpoints and the
18 suggestions by outside parties as to how the system
19 could work better. And really, there's no shortage
20 of views on the patent system and what could be done
21 to better process patent applications and evaluate
22 them, and that's a good thing. I think that it's
23 good for the country to be focused on such an

1 important part of our economic system.

2 We've taken a close look at the NAS and FTC
3 reports and found some things that we're very much in
4 agreement upon, and we appreciate their insights and
5 views. And we're also constantly considering how to
6 do things better on the inside. You know, what can
7 we do within our powers and parameters to make the
8 patent system better? We're focused on reforms that
9 improve patent quality, first and foremost, and, of
10 course, reduce the tremendous backlog of applications
11 that are waiting to be examined.

12 Today we have a backlog of approximately
13 600,000 unexamined patent applications. And to put
14 that in perspective, if we were to close our doors
15 today, it would take about two years to work off that
16 backlog. And then when we opened the doors again,
17 we'd have over 850,000 applications probably sitting
18 at the door if our growth rate continued, so it's
19 quite a daunting challenge. Still, knowing those
20 statistics, we're the quickest and least expensive
21 patent processing office in the world. But if we
22 don't implement some operational policy changes, the
23 backlog will continue to grow at unacceptable

1 proportions. And that would have a negative effect
2 on patent quality and, we think, discourage
3 innovation, because the longer people have to wait
4 for patents, the more corporations will be encouraged
5 to increase the use of trade secret protections,
6 which means a decline in the publication and sharing
7 of useful discoveries and information.

8 Also, a large backlog can impede the
9 financing of new ideas and the release of new
10 products, and it contributes to legal uncertainty as
11 competitors try to get around un-issued patents.
12 Therefore, we're taking several steps, which were
13 detailed in my written testimony, to address quality
14 and pendency. We're implementing more quality
15 training and testing, and we're reforming the way we
16 handle *ex parte* reexamination and appeal briefs
17 within the office.

18 But we also believe that more has to be done
19 to have a more open and transparent and helpful
20 patent application process. So we are in the process
21 of considering a rules package that will address
22 certain areas in the patent application process.
23 We're going to focus on claims and continuing

1 applications and information disclosure statements,
2 again, which I'd be happy to get into more detail
3 about. We believe that if we can strike the right
4 balance with some of these proposals, we will add
5 more certainty, which is important, and increase the
6 quality and efficiency of our patent system. We're
7 also supportive of some of the things that Congress
8 is looking at and Chairman Lamar Smith's bill, and
9 we've been working as appropriate with members of
10 Congress and others to address the issues in the
11 bill. So I appreciate the opportunity to appear
12 before you today, and I look forward to questions.
13 Thank you.

14 CHAIRPERSON GARZA: Thank you. Mr. Merrill.

15 MR. MERRILL: Thank you very much. I, too,
16 appreciate the invitation to appear here today. As
17 you know, my comments are based on a peer-reviewed
18 report assessing the operation of the patent system
19 that was issued by the National Academies in April of
20 2004. It was written by a committee chaired by
21 Richard Levin, the President of Yale, an economist,
22 and Mark Myers, former Sr. VP of Xerox and an
23 engineer.

1 And that I think is the distinctive feature
2 of the work of the Academies on patent policy over
3 the last several years, namely that it has
4 incorporated the views, expertise, and experience of
5 a large number of economists, technical people, both
6 in basic science and in engineering, and investors as
7 well as practitioners. We're about to issue a second
8 report, on the 17th of November, on a specialized
9 area of patents, namely gene sequences and proteins,
10 by a similarly composed panel. The first committee's
11 recommendations could be grouped into three areas:
12 first, simplifying and reducing the cost and the
13 uncertainty of litigation by removing or modifying
14 so-called subjective issues of litigation; second,
15 achieving greater harmonization among the three major
16 patent systems - Europe, Japan, and the United States
17 - to reduce transaction costs on international
18 commerce; and finally, raising the quality of
19 patents, and that's the issue I want to address in my
20 remarks.

21 Susan has done an excellent job of talking
22 about what quality is and why it is important. I
23 want to say a word about what the Academy concluded

1 about quality and what it recommended should be done
2 to address it. It was cautious, I should say, in its
3 conclusions, because the indicators of a
4 deterioration in patent quality that the committee
5 relied on in coming to its conclusions are quite
6 indirect.

7 First of all, the resources, particularly
8 human resources, of the Patent and Trademark Office
9 have not kept pace with the workload. Secondly,
10 although the approval rate of patents in the U.S.
11 appears to be a significantly higher than in Europe
12 or Japan, there's a lot of dispute about the numbers
13 there. There were significant changes in the
14 treatment of genomic and business-method patents,
15 which I think both the industrial and technical
16 communities have viewed as positive steps, namely
17 second review of business-method patents and revised
18 utility standards, which bore most heavily in the
19 area of genomic patenting. And finally, the
20 committee attorneys came to the judgment that there
21 had been some dilution, particularly in
22 biotechnology, of the non-obviousness standard.

23 Since our Report came out, there have been

1 some other indications that we haven't examined or
2 evaluated in detail of deterioration in patent
3 quality. Some academics and practitioners actually
4 peer reviewed a large sample of issued biotech
5 patents and published the results in *Science* magazine
6 earlier this year. I think they found approximately
7 one-third of the issued claims in that category of
8 biotechnology patents were suspect. And there has
9 been a survey by the Intellectual Property Owners
10 Association of their membership, asking their views
11 of whether there has been a deterioration in patent
12 quality, and they were quite affirmative on that
13 question.

14 What are the sources? First, standards and
15 their interpretation, of course. Second, resources,
16 not only the number of examiners and their
17 qualifications, but also access to and the existence
18 of sources of prior art, and time on task. And
19 third, and most difficult to tackle, is the question
20 of the bureaucratic culture of the Patent Office, the
21 expectations of and incentives for patent examiners.
22 We didn't look at all of those issues. In
23 particular, we did not examine in any detail the

1 management and bureaucratic culture of the Patent
2 Office. We weren't asked to do so by the Patent
3 Office, and we felt that was an issue we could only
4 address if we had the enthusiastic cooperation of the
5 Patent Office. But we did look at a number of these
6 aspects and came up with the following
7 recommendations. First of all, the USPTO needs an
8 infusion of new resources, not just in numbers of
9 examiners and budget figures, but also in terms of
10 the analytic capability within the Patent Office,
11 particularly with respect to anticipating changes in
12 technology and their implications for Patent Office
13 operations.

14 With respect to standards of patentability,
15 we didn't recommend legislation, but we said the
16 courts should revisit the question of non-
17 obviousness, particularly in the area of
18 biotechnology. And most importantly, we recommended,
19 as have others, a strong post-grant review system,
20 provided that the time and cost of such a process are
21 contained, and it is an attractive alternative to
22 litigation, though obviously not barring appeals from
23 it. This would require legislation.

1 Why post-grant review? Well, first of all,
2 because we thought that it was relatively efficient
3 to focus the resources on what are viewed as
4 commercially important or potentially commercially
5 important patents. Second, it enables a much faster
6 and cheaper resolution of validity questions than
7 litigation. Third, it is in some respects, or could
8 be, a more expert resolution of validity questions
9 if, as the academy panel recommended, and this has
10 not played a prominent role in subsequent
11 discussions, the courts were encouraged to refer
12 validity questions to administrative determination by
13 the Patent Office. And finally, it would provide
14 earlier guidance to examiners about evolving
15 standards in new areas of technology. Thanks very
16 much.

17 CHAIRPERSON GARZA: Thank you. Mr. Detkin.

18 MR. DETKIN: Thank you, and I appreciate the
19 opportunity -- I appreciate the invitation to come
20 and testify before you folks. I attended part of
21 this morning's panel, and it was clear to me that you
22 folks have had a chance to carefully read these
23 statements, so I will be brief and high level and

1 look forward to your questions.

2 The basic message that I was trying to get
3 across in my testimony is that, yes, there are issues
4 that exist, but they're subtle issues, and subsidiary
5 to that is that, if they're subtle issues,
6 legislating with a heavy hand is definitely not
7 called for here, and we need real data, not
8 anecdotes, before we do any legislating. Let's be
9 sure we know what the problem is, and not just based
10 on anecdotes, not based on polls of what people
11 think, but what the real problem to be solved is, and
12 what the way to pinpoint a solution to that problem
13 would be without upsetting the entire system.

14 A quick background on myself: unlike I think
15 everybody here, I'm not an antitrust lawyer, I'm not
16 an economist, and I'm not an academic; my background
17 is basically having practiced in this field. I spent
18 the first part of my career as an associate and then
19 a partner at a law firm in Silicon Valley, which is
20 known for representing start-ups. In fact, I spent
21 the bulk of my career -- I didn't mention this in my
22 testimony, so this will be new -- representing a lot
23 of companies in litigation with a certain large semi-

1 conductor company in Silicon Valley. I then went to
2 work for that large semi-conductor company, Intel
3 Corporation, as Vice President and Assistant General
4 Counsel responsible for all IP matters, including
5 both the patent portfolio litigation policy and
6 antitrust policy, and I negotiated the settlement
7 with the FTC, and I handled that litigation back when
8 that was a big litigation.

9 And now I am the principal in a venture that
10 is mostly investing in inventions, including
11 intellectual property. So, as a result, I have seen,
12 I think, the intellectual property system through a
13 very different end of the periscope than the typical
14 economist, not that there is such a thing as a
15 typical economist or antitrust lawyer. One thing for
16 which I've gained some notoriety is, I created the
17 term "patent trolls;" I heard it used this morning,
18 and you'll see it now used in the popular press.

19 CHAIRPERSON GARZA: We avoided using those
20 words this morning, I believe.

21 MR. DETKIN: Oh, no, I heard it; I heard the
22 phrase from one of the panelists and one of the
23 Commissioners. It seems to me the phrase has taken

1 on a life of its own. It's almost used now as a
2 placeholder. I guess I'm gratified in a certain
3 respect; I didn't expect the phrase to get that much
4 equity. But the phrase is almost used as a
5 placeholder for all the ills that are perceived in
6 the patent system. And now a "troll" is almost
7 equivalent to a plaintiff you don't like. When
8 there's a plaintiff you don't like, he must be a
9 troll. Let me reiterate, just because a patent
10 plaintiff doesn't make a product, it doesn't make
11 that person a troll. It's very hard to call
12 University of Wisconsin a troll; it's very hard to
13 call NASA a troll. A number of other companies that
14 are out there do a lot of research, getting patents
15 that we want to encourage; they aren't necessarily
16 trolls. And a typical example, of course, is Thomas
17 Edison, a great American hero who did nothing but
18 invent, get patents, and license, didn't productize.

19 At the end of the day it's perfectly
20 honorable to make a product without making -- I'm
21 sorry, to make a patent to invent without focusing on
22 products. And one other area that I think people
23 should focus on that we sometimes lose sight of is

1 not just the trolls, but so-called patent squatters,
2 not a term that I'm going to claim credit for, but my
3 partner, in fact, came up with, and these are folks
4 who didn't win the race to invent but somehow feel
5 it's their right to use the invention that someone
6 else got the reward for.

7 They build a company or a business relying
8 on the rights that have been awarded to somebody
9 else, and then they complain to Congress when someone
10 knocks on the door saying, "Hey, I'd like to be
11 compensated for those rights." And I use the
12 example, the analogy of Home Depot. I certainly
13 don't mean to pick on Home Depot in the testimony,
14 but, you know, it's like any big-box retailer
15 deciding to put up a store before they even check the
16 title and then complaining when someone says, "Hey,
17 that's my land."

18 Companies that market products without ever
19 doing any patent clearances, and this is something
20 that everybody testified about at the FTC hearings
21 and routinely will talk about -- in the high-tech
22 industry, people do not do product clearances, and
23 then they demand that the inventor litigate to get

1 fair compensation, and they should not be heard to
2 complain about the property rights system.

3 Now, let me -- in fact, this morning people
4 talked about patents, that the essential right of a
5 patent is the right to exclude. There's universal
6 agreement on the panel this morning about that being
7 the very essence of a patent right. It's not
8 absolute, and nobody is suggesting it should be
9 absolute, but still, before we take away the very
10 essential right of a patent, one would think that
11 that would be legislating with a heavy hand, and we
12 should have some data.

13 As I mentioned in my testimony, if you ask
14 companies if they have ever actually been enjoined by
15 a troll, not a hand goes up. I mentioned also, for
16 example, the case involving BlackBerry --
17 BlackBerry are going to be shut down. I've heard
18 that for two years now; that injunction has been in
19 place for two years, yet everybody still has his or
20 her BlackBerry. I see everybody using it at break.
21 They've had two years to design around them.
22 Fortunately, as has been noticed, that controversial
23 proposal has been out of the House-proposed reform

1 bill, and we would argue that that should stay that
2 way.

3 I can see I'm running out of time, so I
4 would like to just simply reiterate my call for more
5 data. There's no evidence that patents are, for
6 example, really poor quality. There's no evidence
7 that patents are being invalidated *en masse* by the
8 courts or in re-exams. Could they be of better
9 quality? Yes, probably. But is there evidence that
10 there are hundreds of thousands of really poor
11 quality patents out there? I would argue that
12 anecdotes and polls are not evidence. Thank you. I
13 look forward to your questions.

14 CHAIRPERSON GARZA: Thank you. Professor
15 Lemley.

16 PROFESSOR LEMLEY: Thank you. I want to
17 start by emphasizing the importance of the patent
18 system. Patents, it seems to me, are critical to
19 innovation. And as a general matter, the patent
20 system, while it's not perfect, works very well.
21 Nonetheless, that doesn't mean it can't be improved,
22 and I am a strong proponent of reforms of the patent
23 system in a couple of areas. Notably, one of those

1 areas is not, as you've heard other people on this
2 panel today talk about, improvement of patent
3 quality. I'm in favor of better quality patents
4 rather than worse quality patents, to the extent we
5 can get them, of course, but I don't think that our
6 money and our resources, either inventors' money and
7 resources or the government's money and resources are
8 best spent chasing down and eliminating all the bad
9 patents in the world. I don't think it's ever going
10 to happen, and we ought to focus our attention
11 elsewhere.

12 One thing we can do that I think is
13 relatively uncontroversial so far in the current
14 patent reform proposal is, simplify the patent system
15 to the extent we can by harmonizing it
16 internationally, and by eliminating some of the
17 unnecessary complexities that are attendant to it,
18 and the bill pending in the House, H.R.2795, would do
19 that in various respects, and I endorse that.

20 The other significant change, though, that
21 needs to be made, and here I'm going to diverge a bit
22 from Mr. Detkin, is, there is a problem of litigation
23 abuse in the patent system, and that perhaps should

1 not be surprising, right? Whenever the government
2 grants rights to private parties, there are going to
3 be private parties who try to take advantage of those
4 grants to get more than what it is that the law does
5 or entitle them to.

6 And that litigation abuse is rampant. I
7 agree with Peter that the focus ought not be on
8 trolls. We can't identify a specific category of
9 people, non-manufacturing patent owners, and say
10 they're all bad and everyone else is good. The focus
11 instead, it seems to me, ought to be on the various
12 ways in which the patent system currently encourages
13 people to game the system by filing an endless number
14 of continuation applications, for example, and to get
15 resources out of defendants that far exceed the
16 patentees' own contributions. So our damages rules,
17 our -- with respect to Peter, effectively mandatory
18 injunctive relief rules under the court's current
19 precedence, and --

20 MR. DETKIN: -- save time for rebuttal, I
21 forget.

22 PROFESSOR LEMLEY: -- and our sort of
23 bizarre definitions of willful patent infringement in

1 the legal system all amount to an ability for
2 someone, especially if they wait, lurk in the
3 background while other people develop products to pop
4 up later and demand not just appropriate compensation
5 for something they invented first, but
6 disproportionate compensation.

7 Peter mentioned BlackBerry, which, it's
8 true, has not yet been enjoined, though the hurdles
9 seem to be disappearing rapidly. But the BlackBerry
10 case also involved a damages claim sort of going back
11 for prior infringement, and the court found \$50
12 million in liability. The parties are considering
13 settling that case for somewhere between \$450 million
14 and \$1 billion in order to avoid the threat of an
15 injunction. The threat of an injunction is, in other
16 words, somewhere between nine and 20 times as
17 valuable as the actual calculated value of the
18 patentee's contribution in the past. That's not
19 because it suddenly increased in value; it's because
20 the patentee can threaten to hold up not just his or
21 her own contribution, but everyone else's
22 contributions to a product, as well. H.R.2795, as
23 originally drafted, had a number of provisions

1 designed to deal with litigation abuse. A number of
2 those have been whittled out of the bill, but there
3 are still some that I think are good: willfulness
4 reform, for example, is a good thing. I'm very
5 encouraged to hear the PTO is talking about reform of
6 continuation practice abuse in its written testimony.

7 So I encourage the Commission to endorse
8 patent reform designed first to deal with
9 harmonization and simplification, and second, to deal
10 with the problem of litigation abuse, not to tackle
11 patents or think patents are a bad thing, but to try
12 to get them proportionally considered in the overall
13 innovation context, so that patents don't
14 inadvertently end up eliminating, rather than
15 encouraging, innovation.

16 I've also noted in my testimony some things
17 that I think the Commission could focus on that deal
18 with the patent system but are specifically antitrust
19 issues. And let me just mention two of those in
20 particular; one is abuse of the Hatch-Waxman
21 regulatory process in the pharmaceutical context.
22 This has been a significant issue of concern to the
23 Federal Trade Commission over the last several years,

1 of course. We've seen a movement away from reverse
2 payments -- paying your competitor to stay out of the
3 market -- I think because of the FTC's scrutiny, but
4 we see a number of other practices that might or
5 might not be illegal under the antitrust laws, but in
6 which we could use some guidance from the antitrust
7 laws with respect to product changes or deals between
8 patent owners and generics that might, in fact,
9 interfere with the incentives of generics to enter
10 the market.

11 And finally, I'll note that one other area
12 in which antitrust law could play a very important
13 role has to do with standard-setting organizations
14 who deal with intellectual property on a regular
15 basis, giving standard-setting organizations the
16 freedom to know in advance, before they adopt a
17 standard, who has patents and what they're willing to
18 charge for those patents. That would, I think, give
19 all of the companies in an industry a clear idea of
20 the true cost of adopting a particular technology
21 before they adopt it.

22 Right now they're afraid, I think probably
23 too afraid, of antitrust liability, because they're

1 competitors in a room, and they don't want to talk
2 about price at all, but some kind of guidance that
3 suggested that that negotiation or discussion was
4 permissible I think would be desirable. Thanks.

5 CHAIRPERSON GARZA: Thank you. Mr. Stack.

6 MR. STACK: Thank you. I'm here today on
7 behalf of the American Intellectual Property Law
8 Association, where I chair the Antitrust Law
9 Committee. AIPLA appreciates the opportunity to
10 appear before the Commission as it considers the
11 subject of patent reform. Like each of you, my
12 discipline is antitrust, not patent law, so let's
13 face it, I'm not going to have a lot of profound
14 insights into how to reform patent law practice and
15 procedure. If you want those kinds of insights, I'll
16 refer you to the 90 pages of single-spaced commentary
17 that AIPLA has submitted to the Commission.

18 What I would like to do is put myself in
19 your shoes and ask the question, what, if anything,
20 can we as antitrust lawyers say about reforming a
21 system of law, and I'm speaking of patent law,
22 obviously, of which we have limited knowledge and
23 experience and limited resources to investigate? Let

1 me add that these are my personal views, not those of
2 AIPLA.

3 For this purpose, I would put various
4 recommendations of the FTC and NAS into three
5 categories. The first involves specific aspects of
6 patent law and procedure that are the principal
7 domain of patent lawyers. Examples in this category
8 would include recommendations relating to burden of
9 proof, patent examination procedures, standards of
10 patentability, user rights, best-mode requirements,
11 and the like; these I would avoid. They are topics
12 on which the Commission is likely to have the least
13 relevant expertise and the least credibility.

14 They are also topics that require the most
15 comprehensive knowledge of U.S. and foreign patent
16 systems. The AIPLA commentaries that we've submitted
17 demonstrate how many of the suggestions for patent
18 reform have implications for other doctrines of law
19 and procedure within the U.S. patent system and for
20 the goal of harmonizing the U.S. patent system with
21 other patent systems of the world. It seems to me
22 that without a comprehensive grasp of this entire
23 framework and how each piece interrelates with the

1 whole, the potential for unintended consequences from
2 isolated or specific recommendations is serious; in
3 four words, I wouldn't go there.

4 The second category involves general
5 statements about which there seems to be consensus
6 among patent and antitrust lawyers. In this
7 category, I would include the following; first,
8 patents that do not meet the standards of
9 patentability impede innovation and competition.
10 More specifically, to the extent that current
11 standards of non-obviousness are producing patents
12 that do not meet patentability standards, those
13 standards should be tightened. As for how those
14 standards should be tightened, I would leave that to
15 the patent law experts.

16 Second, the U.S. patent system ought to be
17 harmonized as much as possible with the patent
18 systems of Europe and Japan. We've all experienced
19 global convergence in antitrust. I think we would
20 all agree that it's been a good thing. It's
21 happening in the patent field as well, and it should
22 be encouraged. This will require changing over from
23 a first-to-invent to a first-inventor-to-file system,

1 and that's a significant change. To do so will
2 require adjustments to numerous patent law doctrines,
3 some of which we as antitrust lawyers probably can't
4 even identify. Again, I would leave the details of
5 this to the patent lawyers.

6 Third, to promote investment in innovation,
7 the patent system must strive first and foremost for
8 consistency and predictability. If you compare the
9 level of innovation in the '70's, when there was
10 great uncertainty about the value of patents, to
11 today, that uncertainty has been significantly
12 reduced. I think you can see how important it is to
13 minimize uncertainty. AIPLA agrees with the NAS
14 observation that consistency and predictability
15 depend heavily on retaining a unitary patent system
16 in which the same standards of patentability are
17 applied flexibly to different subject matter
18 inventions.

19 Fourth, Congress should create an effective
20 process for third parties to challenge the validity
21 of patents after they issue. The hallmarks of an
22 effective process are that it be an attractive
23 alternative that challengers will want to use, that

1 it be timely and efficient, and that it be fair.

2 Finally, the capabilities of the PTO need to
3 be strengthened and adequately funded. This could
4 begin by ending Congress's practice of diverting PTO
5 fees to other budgetary uses. It seems to me that
6 commenting on core principles at this level of
7 generality is something the Commission is well
8 equipped to do and should to. These propositions are
9 well supported by the FTC and NAS reports, and I
10 believe the Commission can evaluate them effectively
11 on the basis of its own expertise and critical
12 faculties.

13 My third category of issues are issues that
14 relate directly to antitrust. I have only one issue
15 in this category, and that's the question of
16 inequitable conduct. The NAS report recommends that
17 the defense of inequitable conduct be eliminated or
18 substantially modified. Some legislative proposals
19 provide for, and AIPLA recommends that, inequitable
20 conduct be eliminated as an infringement defense, but
21 treated by the PTO as an internal administrative
22 matter.

23 As we all know, inequitable conduct

1 interlinks closely with fraud on the Patent Office,
2 which can form the basis of an antitrust offense
3 under *Walker Process*. This means that any changes to
4 the inequitable-conduct defense will have significant
5 implications for *Walker Process* cases and *vice versa*.
6 I think the Commission can make an important
7 contribution to the debate over changes to the
8 inequitable conduct defense by exploring the
9 antitrust side of that interrelationship.

10 In my written comments, I noted a number of
11 questions that the Commission might address in that
12 regard, so I won't repeat them here. If this sounds
13 like a fairly unambitious agenda, at least it has the
14 virtue of freeing up Commission resources for the
15 rest of its agenda, which seems to me to be very
16 ambitious indeed, and more in the sweet spot of the
17 Commission's expertise. These are my thoughts, I
18 look forward to the discussion.

19 CHAIRPERSON GARZA: Thank you very much.
20 Commissioner Delrahim.

21 COMMISSIONER DELRAHIM: Thank you. Mr.
22 Stack, you mentioned that you're representing AIPLA,
23 but then you also mentioned you're speaking in your

1 personal capacity; which is it, just for
2 clarification?

3 MR. STACK: My personal capacity.

4 COMMISSIONER DELRAHIM: So this is not --
5 you're not representing the AIPLA's views, or are
6 you?

7 MR. STACK: No; I think many of the things
8 I've said, particularly the generalities, are all
9 consistent with AIPLA's views. With respect to the
10 rest of it, I think that's more me than AIPLA, but of
11 course, we've submitted written statements that do
12 reflect AIPLA's views.

13 COMMISSIONER VALENTINE: The part about
14 unlimited -- is his.

15 MR. STACK: I don't think AIPLA would
16 presume to tell you what your job is.

17 COMMISSIONER DELRAHIM: Thanks much. Mr.
18 Detkin, you were credited with the patent troll
19 terminology that has been used, and back when you
20 commented on patent trolls and their effect on Intel,
21 what were patent trolls doing? What was the problem?

22 MR. DETKIN: What patent trolls were -- the
23 phrase was supposed to convey folks who take a single

1 patent, or perhaps even a single small portfolio of
2 patents, all related subject matter and usually of
3 dubious merit or making assertions of dubious merit,
4 and seeking nuisance-value settlements. The case
5 that spawned the phrase is instructive here. It was
6 a case involving a single patent on a so called RISC
7 microprocessor, which is very different than a CISC
8 microprocessor, which is what Intel made at the time,
9 and the patent holder asserting it against Intel and
10 looking for what we felt was a nuisance-value
11 settlement.

12 Now, in patent litigation, nuisance value is
13 still millions of dollars: unfortunately, that's the
14 nature of the beast. And we decided to put up a
15 stance there, and in fact, we ultimately prevailed
16 both at summary judgment and on appeal. But at the
17 time that I was talking out about it, we had that
18 case -- we had another case or two that were also
19 pending at the same time, one by actually -- which is
20 a record company, but also had a few patents, and a
21 case by a company called *Data Point*.

22 So these were all pending at the same time.
23 They were all single patents, clearly of questionable

1 merit, which was since proved out by the courts, and
2 they were seeking nuisance value settlements, and
3 there are still examples of that today. Like I said,
4 there are some issues out there, but I don't think
5 it's as broad as, you know, everybody is -- again,
6 the phrase has come to mean a lot more than what I
7 intended.

8 COMMISSIONER DELRAHIM: Sure.

9 MR. DETKIN: Do I get a chance to rebut what
10 Mark said? Okay, I'll wait.

11 COMMISSIONER DELRAHIM: You'll get a chance
12 to do that. There will be some questions relating to
13 that specifically.

14 MR. DETKIN: Okay.

15 COMMISSIONER DELRAHIM: Mr. Pinkos, there's
16 been a lot of comment about the continuation process
17 and abuse of the system; some of that has been
18 curtailed by a 20-year patent term of the '99
19 legislation, but for those who continue to publish
20 only in the -- file only in the United States, and
21 hence can keep their patents secret for some time,
22 the continuation practice has pointed to something
23 that needs some reform. I think it is or had been in

1 the House legislation, some reforms, but then
2 yourself and Mr. -- had also commented on some
3 reforms. What specifically are you trying to -- is
4 the PTO doing that you could share with us?

5 MR. PINKOS: Sure, what we're looking at is
6 a situation, just a little bit of background, where
7 we have almost one-third of the applications that
8 come in in a particular year involving continuations.
9 So, in essence, all those applications have been
10 rejected in some aspect before, and people are coming
11 in for a redo.

12 Now, there are a lot of good reasons why
13 they will come in, and so there's a certain amount of
14 continuation practice that is, obviously, very
15 legitimate and necessary. I think the question
16 comes, as in many areas of the law, you know, what's
17 the recourse when you don't prevail initially, and
18 how many opportunities do you get? And I think that
19 what we're looking at is potentially one continuation
20 as a matter of right, and then placing more burden
21 upon the applicants if they want to come in a second,
22 third, or fourth time, and provide more information
23 to the office, point out -- more of a brief type

1 situation where they're going to be talking about
2 certain patentability issues.

3 And I think that that will -- and I should
4 preface it by saying we are considering taking some
5 steps that we believe we have the ability to issue
6 rules on, and we're kind of in the pre-comment period
7 in the sense that we are seeking legitimate advice
8 and suggestions before we roll these out, but that's
9 the general gist of what we're thinking of doing with
10 continuations.

11 COMMISSIONER DELRAHIM: Is that something
12 that the practice, at least as you know or anybody on
13 the panel would think would harm the inventors'
14 incentive? Ms. DeSanti?

15 MS. DeSANTI: I would think not. And I do
16 want to say, I want to preface all my comments by
17 saying, the FTC came through the process of the
18 hearings and the report with an immense respect for
19 the PTO, which does an unbelievable job in
20 circumstances that are literally probably impossible
21 to deal with, especially at current funding levels.
22 I understand a theoretical possibility of incentives
23 curtailed from limiting continuations, but I would

1 think from what Mr. Pinkos is saying, there would be
2 an opportunity to explain to the PTO why a subsequent
3 continuation would be necessary. And I would rely on
4 the PTO's judgment to say, "Yes, indeed, we
5 understand, and we'll let you come and explain
6 again."

7 COMMISSIONER DELRAHIM: Mr. Detkin.

8 MR. DETKIN: I do believe that some
9 limitation on the ability to file continuations,
10 unlimited continuations, is appropriate, and what Mr.
11 Pinkos is suggesting sounds like a reasonable step.
12 I'd like to see more about what he proposes in terms
13 of the additional hurdles that would be placed, but I
14 do believe -- I do agree in general that it sounds
15 like a reasonable approach.

16 COMMISSIONER DELRAHIM: Mr. Lemley.

17 PROFESSOR LEMLEY: Yeah, I endorse the
18 approach entirely.

19 COMMISSIONER DELRAHIM: Mr. Merrill.

20 MR. MERRILL: We didn't specifically examine
21 the issue. We did, however, recommend removal of one
22 source of abuse, which is to eliminate the exception
23 for non-publication of applications, which I think is

1 important.

2 COMMISSIONER DELRAHIM: Mr. Detkin, would
3 you oppose the exception for publication only in a
4 domestic filing situation?

5 MR. DETKIN: Yes.

6 COMMISSIONER DELRAHIM: Why is that?

7 MR. DETKIN: I'm sorry, would I -- no.

8 COMMISSIONER DELRAHIM: Would you oppose it?

9 MR. DETKIN: Would I oppose it? No; I think
10 that that's --

11 COMMISSIONER DELRAHIM: It makes sense?

12 MR. DETKIN: It makes sense, yeah.

13 COMMISSIONER DELRAHIM: Professor Lemley,
14 Professor Shapiro, in the prior panel, I don't know
15 if you were in the room when Commissioner Valentine
16 had asked the question regarding the language that
17 you had suggested with respect to injunctive relief,
18 and he said that that would be more akin to
19 compulsory licensing; do you agree?

20 PROFESSOR LEMLEY: No, I don't. So, I mean,
21 let me be clear that I think that the rule of
22 injunctive relief in patents is important, and in the
23 overwhelming number of cases, injunctive relief is

1 appropriate. Frankly, what I think ought to happen
2 is exactly what is in current law. Current statute
3 says courts may grant injunctions in accordance with
4 principles of equity.

5 The problem is that the Federal Circuit has
6 changed "may" to "shall" grant injunctions,
7 regardless of principles of equity, leaving only one
8 exception, and that's a possible exception for public
9 health. And so if we could get back to a world,
10 which I think Congress originally envisioned, in
11 which the normal rule would be an injunctive rule,
12 but in some limited circumstances, where there were
13 patent owners who had no interest except money, who
14 weren't going to be harmed by being compensated in
15 money damages, and where the risk to the accused
16 infringer was significant, not just in terms of being
17 stopped from using the infringing product, but being
18 stopped from using a whole bunch of other products
19 that are bound together in the same ultimate sale,
20 then I think the court ought to have discretion --
21 injunctive relief.

22 Now, it's true, in that case they would be
23 compensated only in money damages, but that's

1 perfectly consistent with any other property regime,
2 real property, or chattels, or anything else, where
3 sometimes you're not going to get injunctive relief.

4 COMMISSIONER DELRAHIM: Mr. Detkin, I'm sure
5 you'd like to comment on that.

6 MR. DETKIN: We actually agree a little bit
7 more than people would expect. I also agree that the
8 current laws are sufficient. Where we disagree is
9 how the courts have been applying the current laws.
10 I wholeheartedly disagree that, I think the phrase
11 Mark used was effectively mandatory. Injunctions are
12 absolutely not effectively mandatory in the court
13 system. There are several cases, in fact, I believe
14 Mr. Lemley cited them, excuse me, Professor Lemley
15 cited them in his amicus brief in the eBay case,
16 where the CAFC affirmed the denial of an injunction
17 in the District Court below. So the courts are
18 looking at the public interest, and not only in cases
19 involving public health, but other situations as
20 well. So I believe that the law, as written, is
21 perfectly appropriate.

22 COMMISSIONER DELRAHIM: Ms. DeSanti.

23 MS. DeSANTI: Well, I want to clarify, this

1 is an issue on which the FTC did not make any
2 recommendations. I would simply say with reference
3 to whether the current law is mandatory with respect
4 to injunctions, it's my understanding that with
5 respect to permanent injunctions, once a patent has
6 finally, after all appeals, been declared valid and
7 infringed, then an injunction will issue in 99.99
8 percent of the cases.

9 COMMISSIONER DELRAHIM: Mr. Merrill.

10 MR. MERRILL: We didn't examine the issue.

11 COMMISSIONER DELRAHIM: With respect to
12 standard-setting organizations, we haven't focused
13 much on that, but there's been some cases that the
14 Federal Trade Commission has brought in the *Unocal*
15 case and in the *Rambus* case, and the status of the
16 law has been, even though there are concerns about
17 competition and hold-up by one of the patent owners
18 of not disclosing the ownership, there's obviously an
19 effect on competition through the hold-up, but the
20 ruling was that the FTC did not have authority and
21 the brief parties should go to the state fraud
22 standard; should there be a federal fraud standard in
23 standard setting or in the standard-setting process

1 and expand that power and grant the FTC the authority
2 to challenge conduct like the issue that was
3 presented in *Rambus*? Mr. Detkin.

4 MR. DETKIN: No, I don't believe so. I
5 believe that these are sophisticated companies who
6 know how to arrange for the dealings among
7 themselves. And whether or not Rambus violated the
8 rules of that particular -- organization is a
9 question simply of how those rules were drafted,
10 which I'll take absolutely no position on, and
11 whether or not they were drafted appropriately, and
12 hopefully the standard-setting organizations will
13 learn from whatever mistakes were present there and
14 draft the rules a little bit more tightly next time.

15 COMMISSIONER DELRAHIM: Mr. Stack, as an
16 antitrust lawyer, do you have any views on that?

17 MR. STACK: I don't have that much
18 experience with standards organizations. But I have
19 read the *Rambus* case, and clearly it seemed to me
20 that the problem there was articulating what the
21 rule, in fact, was. And I tend to agree with what
22 was just said, that it ought to be left to the
23 standards organization, because they have to balance

1 a number of different factors in terms of incentives
2 to disclose patents, scope of search within the
3 company for patents and things like that, so I would
4 generally say, leave it up to the standards
5 organization to articulate the standard.

6 COMMISSIONER DELRAHIM: Professor Lemley.

7 PROFESSOR LEMLEY: So I agree that the first
8 line of defense ought to be in the private standard
9 setting organization, and that's one of the reasons,
10 in my written testimony, I suggest making it easier
11 for standard-setting organizations to adopt rules
12 that give them the information they need ahead of
13 time and enable them to deal with the potential for
14 hold-up and abuse.

15 I think also that some of the patent reform
16 changes that deal with litigation abuse would make
17 the problem at least less severe. One of the reasons
18 that Rambus can do what it does is, it's got -- once
19 the standard has been adopted and everyone uses it,
20 it's got power to charge, and I believe actually did
21 charge almost five times as much money as for patents
22 for which the standard had not been adopted.

23 I guess my view is, antitrust can serve as a

1 backstop in rare cases in this conduct, and the
2 *Unocal* case may well be a good example of that, where
3 the sort of abuse was abusive of a government
4 standard-setting process, and so it's not clear that
5 private standard-setting organizations could or would
6 have solved the problem of abuse. I don't think we
7 need a new federal fraud law or new and expanded
8 antitrust rights to do that, though. I think that,
9 properly understood, Section 2 claims in very rare
10 circumstances will be appropriate.

11 COMMISSIONER DELRAHIM: Ms. DeSanti.

12 MS. DeSANTI: Thank you. I just want to
13 clarify that the fraud decision that you're speaking
14 about was from the Federal Circuit. The Commission
15 still has on appeal a *Rambus* case that it's
16 evaluating under the antitrust law, which, of course,
17 I can't say anything about. I just want to point out
18 that Chairman Majoras did give a recent speech out at
19 Stanford addressing this issue of hold-up and
20 clarifying the FTC's view that joint *ex ante* royalty
21 discussions that are reasonably necessary to avoid
22 hold up do not warrant *per se* condemnation; rather,
23 they merit the balancing undertaken in a rule of

1 reason review, and we would apply the rule of reason
2 to joint *ex ante* royalty discussions because, quite
3 simply, they can be a sensible way of preventing hold
4 up, which can itself be anti-competitive.

5 MR. DETKIN: Mark and I have very different
6 views of the facts in two cases that are relevant to
7 this discussion. First, Mark mentioned the *NTP* case,
8 where -- as far as he goes, that the damages award
9 was \$50 million, and the negotiations led to a
10 license agreement that's around \$450 million, perhaps
11 a little bit more; obviously, I don't know the
12 details.

13 But what is important to keep in mind here
14 is that the \$50 million was back damages for six
15 years prior to when litigation was filed, and during
16 the time when BlackBerry was first ramping up in
17 popularity. What the \$450 million is for is for
18 forward-going license. It's not unreasonable to
19 think that, considering the popularity of BlackBerry,
20 that a license for the lifetime of that patent is
21 worth nine times the value of the six years prior to
22 when litigation was filed, so I see absolutely
23 nothing wrong with that negotiation. Similarly, we

1 just mentioned the *Rambus* case, and Mark claims that
2 that is evidence of hold-up; again, I strongly
3 disagree. What Rambus is charging is, yes, I think
4 it's three and a half percent for SDRAM technology
5 and .75 percent, I believe, for their RDRAM
6 technology, and the reason is, they're trying to get
7 people to convert, they're trying to influence the
8 market to convert over to their technology.

9 They'd much rather collect .75 percent of
10 RDRAM so they get to sell a technology license as
11 opposed to 3.5 percent of SDRAM, assuming that they
12 actually have claims on that particular technology.
13 I don't know; I haven't studied those patents in a
14 long time. But the point is, they're using their
15 patents to try to influence their market to move
16 towards technology where they think they can make
17 more money, which is kind of why they're in business.
18 So I think that their motivation is not a hold up,
19 it's to try to get people, in fact, moving more
20 towards their technology, which they believe is
21 superior.

22 COMMISSIONER DELRAHIM: Professor Lemley,
23 did you have any further comments on that?

1 PROFESSOR LEMLEY: Sure, and I don't want to
2 chase us down rabbit holes here, right. If I recall
3 correctly, the *NTP* versus -- patent issued in 1991,
4 so it's going to expire in three years. So, yeah,
5 Peter's right, the damages award -- the settlement
6 would include not just the \$50 million for six years
7 of back damages, it also include three years going
8 forward, and maybe since there are more sales, maybe
9 that would total out to \$100 million or so.

10 MR. DETKIN: You lost 11 years in that.

11 PROFESSOR LEMLEY: Well, no, you can only
12 get six years of back damages under the Statute of
13 Limitations, right, but from 1991 to 2008 is the
14 patent term. The patent term is going to end in
15 three years. And, you know, in terms of Rambus, I
16 mean, again, the facts are I guess in dispute, but it
17 seems pretty clear to me that Rambus affirmatively
18 and aggressively altered its patent applications
19 using the continuation process precisely in order to
20 cover the standard that was chosen by JEDEC.

21 That doesn't seem to me the behavior
22 necessarily of someone who's trying to influence the
23 technology into their direction; maybe it is, but it

1 seems to me actually opportunistic; they want, at a
2 minimum, to capture some of the value in the SDRAM
3 technology, and they're doing so not by being up
4 front, saying, "We have rights in this technology,
5 and here's how much we're willing to charge for
6 them," but by waiting until the industry has adopted
7 that technology.

8 COMMISSIONER JACOBSON: The FTC and perhaps
9 some court of appeals will tell us what the facts and
10 law are on the *Rambus* case.

11 COMMISSIONER DELRAHIM: Mr. Pinkos, patent
12 quality has been a large part of this debate,
13 concerns that the quality coming out of the PTO is
14 not good; patents or weak patents haven't been fully
15 searched. Is that accurate? Two, what specifically
16 are you doing to try to improve quality and address
17 the increasing need for the PTO's resources?

18 MR. PINKOS: Well, I think when it comes to
19 patent quality, patent quality is sort of determined
20 by the -- it's in the eye of the patent beholder, so
21 to speak. I mean one person's poor patent is another
22 person's, you know, meal ticket. And it's
23 interesting this year: in the last six months of the

1 year, we really focused on literally reviewing every
2 single allowance by the office, and what we saw was a
3 downturn in the issuance rate. We're going to be
4 below 60 percent for the first time in many, many
5 years, if ever, and the response to that was rather
6 interesting.

7 Some people cheered and said that, you know,
8 "They're giving greater scrutiny to patents and
9 that's what's necessary," and "They're bringing more
10 certainty to the system." Other people who complain
11 about certain patents because perhaps they're being
12 sued, and some of the suits that alleged are not
13 particularly legitimate, on the other side came back
14 and said, "Well, our patent portfolio is really
15 shrinking this year. We had 1,500 applications, and
16 we expected to see so many patents issued, and we
17 didn't," because they thought their patents were very
18 good, and other peoples' patents were not. So I
19 think, again, what I'm trying to say is that, it's
20 really -- it is a bit of a double-edged sword. But
21 the bottom line is that we take patent quality
22 extremely seriously. We would like it to be deemed
23 that every single patent going out of the office is

1 beyond reproach. The reality is that the error rate,
2 as we've measured it by traditional approaches, is
3 about four to seven percent per year.

4 This year, again, we drove it down to a
5 little under four percent in the last half of the
6 year by re-examining every single patent application.
7 But we're doing things differently than we have in
8 the past; we're reviewing not just the end-product,
9 but we're reviewing it along the way, and I think
10 it's important to review by the time of a first
11 action so that you don't get all the way to the end
12 of the game and have a poorly issued patent.

13 We are recertifying patent examiners, which
14 has been controversial inside the office, to say the
15 least, to make sure -- to reach a certain grade, that
16 they are still very -- that their skills are finely
17 tuned. We're also thinking about using our quality
18 reviewers to analyze more of the end-process and
19 train better on the errors they're seeing, so again,
20 things don't make it to the end with errors in them.
21 And we're also seeking to convene panels of outside
22 folks to give their input on patent quality, and
23 we're asking what the users of the Office think. I

1 mean, we're hearing a lot about it, but we want to
2 reach out in some particular organized fashion to
3 convene that. You did ask about resources; the
4 Administration has advocated now for a couple of
5 years that the Office should keep all of the fees
6 that it collects. Congress last year essentially
7 obliged it in the appropriations bill with a
8 conference report that was just filed last Friday.
9 Congress is agreeing to do so again. So the Office
10 does have adequate resources to try to address the
11 quality issues.

12 But what happens sometimes is that, when you
13 focus particularly on quality, which is our number-
14 one priority this year, and I talked about reviewing
15 every single allowance. Well, that takes resources
16 away; that takes quality examiners and quality
17 supervisors away from the production line. So what
18 did we see? Unfortunately, we saw a slight downtake
19 in our production. We didn't meet our production
20 goal for the year, and we're a very production-
21 oriented environment, where we have specific
22 production units that we want to accomplish. So
23 there is some trade-off.

1 But we do have the resources now to tackle
2 the problem, at least for this year, and there hasn't
3 been a -- there's not a permanent solution to the
4 issue of fee diversion, but it's still under
5 consideration by Congress.

6 COMMISSIONER DELRAHIM: Thank you, thanks to
7 the panel.

8 One question, Madam Chair, that I didn't
9 ask, and I would just want to mention it here, and
10 hopefully it will manifest itself in responses to
11 other Commissioner's questions: Mr. Detkin, in your
12 testimony, in your Home Depot example, you discussed
13 the patent clearance study to be performed by a
14 company in order to avoid being a squatter. It would
15 be interesting to hear whether or not, if a company
16 performs such a patent clearance, the injunctive
17 relief or other litigation mechanisms could factor in
18 their favor had they performed such a clearance
19 standard. Hopefully that will come up unless we have
20 time for a response.

21 CHAIRPERSON GARZA: We have a little bit of
22 time, so --

23 COMMISSIONER DELRAHIM: If we have time to

1 respond, that would be great, Mr. Detkin, and others
2 on the panel.

3 MR. DETKIN: Okay, I'll be glad to respond.
4 I think that that will go more towards the willful
5 infringement issue. In other words, the companies
6 are looking for relief from what they believe to be
7 an onerous willful infringement standard and never
8 show whether they're on notice and what they need to
9 do when they're on notice.

10 I think there's more symmetry there between
11 an effort to clear yourself, and, as I say in my
12 testimony, I don't believe for a minute that any
13 decent patent clearance study could possibly cover
14 the entire waterfront, but at least if they're
15 willing to make an effort to see if their patents are
16 infringing anything, it would balance nicely with
17 some relief on the willful infringement standard. I
18 don't believe that there's a corollary, though, or
19 any analogy to the injunction issue.

20 COMMISSIONER DELRAHIM: Would you exclude
21 from that study patents that haven't been issued or
22 published abroad for those who have been --

23 MR. DETKIN: Well, if you can't -- then, of

1 course, I mean, again --

2 COMMISSIONER DELRAHIM: So if it issues
3 later than that same standard, or whether it's
4 willful infringement or whatever the relief might be,
5 could still apply?

6 MR. DETKIN: Sure. You're asking me for
7 details on legislation that I haven't really drafted,
8 but I mean, all I'm suggesting is that companies
9 should be under an affirmative obligation to at least
10 make an effort to find out what's out there; right
11 now they're not doing that.

12 PROFESSOR LEMLEY: Yeah, right. So if -- I
13 think I agree with Peter on this. Right now we
14 affirmatively discourage in the law people from
15 looking at patents, particularly in industries like
16 information technology, where there are a whole bunch
17 of patents out there. People still do searches in
18 medical devices, in pharmaceuticals, because they
19 know they're going to either find nothing or they're
20 going to find one or two patents. If we actually
21 coupled elimination of the kind of bizarre nature of
22 the willfulness rules with some affirmative incentive
23 for people to go out and do a search, for example, by

1 saying that if you went out and did a search and you
2 didn't find a patent, because it had been concealed
3 or not published, or because it was later the subject
4 of a continuation application that changed it, that
5 we reduced damages or reduced remedies, that actually
6 might line up the incentives the right way, so that
7 people could find out what they were up against and
8 preclear those rights.

9 MR. DETKIN: Mark and I agree, shockingly.

10 COMMISSIONER DELRAHIM: Thank you.

11 CHAIRPERSON GARZA: Thank you. Commissioner
12 Warden.

13 COMMISSIONER WARDEN: Thank you. First let
14 me say I agree with the remark that was made that the
15 patent -- what a good patent is is in the eye of the
16 beholder. And I also agree with Mr. Stack's
17 suggestion that whatever problems the patent system
18 may pose for competition in our economy, and I happen
19 to believe they're material, antitrust law is not the
20 way to resolve them.

21 As Mr. Pinkos says, there's nothing that
22 says antitrust law trumps intellectual property law.
23 They both have equal standing. But I find very

1 persuasive both the anecdotal evidence that Mr., I'm
2 sorry, my eyes have fogged over --

3 MR. DETKIN: Detkin.

4 COMMISSIONER WARDEN: -- Mr. Detkin
5 dismisses, and the analysis that Dr. Merrill
6 discussed with respect to bad -- that's the term
7 that's been used here today -- patents, I would say
8 patents of trivia, patents that aren't inventions and
9 so on, and obviously, the solution to that is the one
10 Dr. Merrill suggests, which is resurrection of the
11 non-obviousness standard, but I would also say a
12 standard of non-triviality should be added to that.
13 And I despair of doing anything about this because
14 the Supreme Court, which has a lot more authority
15 than we have, in *Graham v. John Deere*, 39 years ago,
16 lectured the PTO on its failure to obey the
17 Constitutional mandate, as the Supreme Court put it,
18 that there be an invention. And my first question to
19 Mr. Pinkos is, do you require all of your examiners
20 to read *Graham v. John Deere*, 383 US 1?

21 MR. PINKOS: The examiners are, in their
22 initial training, briefed on all of the legal
23 principles and rules that they have to apply. And

1 interestingly, one of their favorite seminars that
2 they participate in the year is the annual update
3 they get from our solicitor on the recent
4 developments in the law. So the answer is, yes,
5 they're very well trained in following the law as it
6 comes from Congress and is interpreted by the courts.

7 COMMISSIONER WARDEN: You have a lot of, not
8 a lot, but some statistics in your written testimony:
9 number of patent examiners, numbers of patents
10 issued, number of applications, and so on. I tried
11 to do a little math, and it looks like it works out
12 to about 35 man-hours of an examiner's time per
13 issued patent. And having had the occasion to look
14 at patents -- I've been in some litigation, not as
15 much as Mr. Detkin by any means -- in this area, I
16 mean it takes two days just to figure out what the
17 hell is being said in the application, and I just
18 don't understand how obedience to the Constitutional
19 and statutory requirements can be achieved at 35 or
20 40 hours per patent, and that's allowing no time for
21 the turn downs; can you respond to that?

22 MR. PINKOS: The time is actually less than
23 that.

1 COMMISSIONER WARDEN: Okay. And how can the
2 system possibly work and produce something that the
3 law puts a presumption of validity on?

4 MR. PINKOS: Well, I think, for one, the
5 time that the patent examiners have is adequate for
6 some, and others struggle to do a good job in that
7 period of time. It also varies depending on the
8 complexity of the art area. For example, we always
9 say mousetraps, you know, there are not a lot of
10 mousetrap applications coming in, but technology
11 similar to that may only get 12 or 14 hours to
12 review, but something much more complex could get 35
13 hours to review. I think one of the keys to
14 improving the process and helping bring more clarity
15 and certainty to the system would be to have better
16 applications coming in, quite frankly.

17 COMMISSIONER WARDEN: I'm sure.

18 MR. PINKOS: So, for example, if you've got,
19 you know, hundreds of references to the point where -
20 - there's a little more direction to the examiner of
21 where the relevance is. It could be much like a
22 legal brief: when you're briefing the appellate
23 court, you present the relevant case law and frame

1 the arguments in your favor, of course, but you lay
2 it all on the table. Sometimes it's a little bit
3 like a needle in a haystack for the examiner, so
4 that's why we're looking at those issues of
5 information-disclosure statements, the number of
6 claims that are submitted, to help, again, bring
7 better quality into the Office, so examiners can do a
8 better quality examination in the time they do have.

9 COMMISSIONER WARDEN: Well, I'm skeptical
10 that there are 170,000 inventions, in the
11 constitutional sense, every year myself. May I just
12 have one more moment? You made reference, Mr.
13 Detkin, to Thomas Edison in your oral testimony, and
14 in your written testimony, you say he made his career
15 by inventing and licensing his patents, not
16 productizing, a word with which I was unfamiliar, but
17 I think I understand.

18 My recollection is that Thomas Edison sold
19 the ticker tape to J.P. Morgan as a working product,
20 not as a piece of paper, not as a patent. And my
21 recollection also is that he was one of the founders
22 of the General Electric Company, originally known as
23 the Edison General Electric Company; does your

1 recollection differ from mine in those two respects?

2 MR. DETKIN: On the ticker tape, I believe
3 he produced a prototype, but he didn't -- he never
4 built a company; he never built more than one.

5 COMMISSIONER WARDEN: Right, but he had a
6 product. Anyway, how about GE?

7 MR. DETKIN: I'll have to be honest, I'm not
8 sure of the genesis of GE. I understand that was
9 much later in his life, and it was primarily based on
10 his inventions around electricity and the whole
11 interesting discussion -- with Nicholas -- about the
12 whole issue.

13 COMMISSIONER WARDEN: True. Thank you.

14 CHAIRPERSON GARZA: Thank you. Commissioner
15 Carlton.

16 COMMISSIONER CARLTON: Okay, thank you.
17 Professor Lemley raised the concern that in standard
18 setting organizations, the standard-setting
19 organization, and to quote from your testimony, "is
20 constrained by the fear of antitrust liability from
21 determining in advance the reasonable royalties," and
22 Susan DeSanti explained how there was just a recent
23 speech by the Chairman of the FTC explaining why that

1 would be dealt with under the rule of reason.

2 I guess my question is, does anyone disagree
3 that that is a reasonable stance, and that if you
4 were advising a standard-setting organization, you
5 would tell the standard-setting organization, "Go
6 ahead and do it, because as long as it's not misused,
7 if it's done for pro-competitive purposes, it would
8 be sensible"?

9 PROFESSOR LEMLEY: If I could address that,
10 I certainly don't disagree with Commissioner Majoras'
11 statement, and I was encouraged to see it. But, of
12 course, the rule of reason can conceal a multitude of
13 sins. And so if you're an antitrust lawyer, I think
14 you can't say go ahead and do it and you're fine, you
15 can say, "Go ahead and do it, and you won't be
16 subject to *per se* condemnation." I think it's
17 probably also fair to say that the FTC has sent
18 appropriate signals that this isn't going to be
19 something they will be affirmatively and aggressively
20 pursuing. But the worry is private antitrust
21 enforcement, and there have been a number of cases
22 filed in private litigation against standard-setting
23 organizations for this sort of behavior. So I think

1 you'd have to counsel your organization that there is
2 some risk associated with doing this.

3 MR. DETKIN: I'm going to take that one step
4 further. This is not an issue that Intellectual
5 Ventures struggles with, but as someone who has
6 counseled very large corporations, I would
7 affirmatively say, under the current law, they'd be
8 crazy to get into a room with any competitors and
9 discuss price-setting under any set of circumstances
10 absent strong and direct guidance from the FTC.

11 COMMISSIONER CARLTON: Okay. Let me turn to
12 another topic that didn't really come up, but I think
13 it's quite important. There's been an explosion in
14 the number of patents issued since say the early
15 '80's, and another consequence of the explosion,
16 other than just more patents out there, is that the
17 amount of cross-licensing in certain industries has,
18 in a sense, replaced royalty payments for licensing
19 intellectual property. Are there any particular
20 antitrust concerns that the cross-licensing movement
21 poses? The cross-licensing movement is one in which
22 one firm gives its intellectual property to another,
23 only if it gets in return intellectual property from

1 the other firm. In a sense, it can freeze out people
2 who don't have the same portfolio, or an intellectual
3 property portfolio. So my question to the panel is,
4 does that raise -- does cross-licensing raise
5 particular concerns that we should pay attention to?

6 PROFESSOR LEMLEY: Yeah, I think you just
7 raised the antitrust worry, though. It's not
8 necessarily -- because it's an antitrust worry
9 doesn't mean it's an antitrust violation. I think
10 cross-licensing in general is vital in these
11 industries for which there are tens of thousands of
12 patents. It's the only way large companies can get
13 along without debilitating litigation. But it is the
14 case that -- one implication of that is that if you
15 don't have your existing patent portfolio and you
16 want to enter the market, you're at a decided
17 disadvantage relative to the ones who do have it.

18 Now, you know, maybe that's a function of
19 the fact that those companies have been inventing,
20 and they're getting some value for their patents,
21 though it's not a direct monetary payment, but it
22 does, I think, cement a kind of all -- structure in
23 certain industries.

1 MR. DETKIN: I disagree. Actually, I do
2 agree with some of what Mark says is inherent in your
3 question. At the end of the day, companies with
4 large patent portfolios are looking for a value for
5 that portfolio, and they may see value in a balancing
6 payment back, or they may see value in a cross-
7 license to the other company's portfolio.

8 Where I disagree, though, is that it's
9 cement in all -- I'm a patent lawyer; I can't even
10 say the word "structure," because -- and I give
11 speeches about this all the time -- in fact, just at
12 Stanford Business School -- a well-counseled start-up
13 with zero patents can very effectively enter a market
14 if it understands the problem ahead of time and works
15 on the problem from the beginning.

16 If I'm going to be a semi -- if I'm starting
17 a semiconductor company, which, by the way, does not
18 require, contrary to popular belief, a \$2 billion
19 investment in a fab -- and it requires 30 people who
20 know how to design semiconductors better, faster, and
21 cheaper than anybody else out there, then go to
22 Taiwan and have it manufactured for you -- if I
23 wanted to start a semiconductor company, I know I've

1 got to deal with Intel, I know I've got to deal with
2 AMD, and I know I have to deal with some of the other
3 entrenched players, National Semiconductor -- I don't
4 mean to pick on anybody in particular -- and if I
5 realize that going in, then I can figure out
6 strategies, and I know I can counsel, and I have
7 counseled companies on strategies for how to deal
8 with that and not be crushed by those companies that
9 are entrenched with large portfolios. And I'd be
10 happy to explain that at length if you'd like, but
11 it's the subject of an hour long lecture at Stanford
12 Business School right now.

13 COMMISSIONER WARDEN: Okay, thank you.

14 MS. DeSANTI: Dennis, I would just like to
15 respond that the issue you raise is one that's worth
16 thinking about, and it is one that the DOJ and the
17 FTC will be thinking -- have been thinking about and
18 will be addressing in the second IP report.
19 Certainly, I do want to emphasize, though, that it
20 came across loud and clear that extensive cross-
21 licensing is, in fact, the way that many companies in
22 computer hardware and software have freedom to
23 operate. And there are, obviously, efficiencies that

1 come across from the cross-licensing, as well as the
2 potential for anti-competitive concerns.

3 COMMISSIONER WARDEN: Okay, thank you.

4 CHAIRPERSON GARZA: Okay. Commissioner
5 Valentine.

6 COMMISSIONER VALENTINE: So little time, so
7 many questions. I'd like to try to cover eliminating
8 inequitable conduct defense, better information
9 disclosure, and post-grant opposition, so let me see
10 if I can focus this. We'll start with post-grant
11 opposition. Mr. Detkin has suggested a standard in
12 which, for nine months after a patent issuance, the
13 opposition procedure should be permitted to occur; he
14 would endorse that. Mr. Lemley would like a second
15 bite, a six-month window after notice of
16 infringement. Mr. Stack, I believe you go with a
17 nine-month standard. Mr. Merrill, it's somewhat
18 unclear from your open-review procedure what you
19 envisage. And I would like to hear from Ms. DeSanti
20 and Mr. Pinkos and Mr. Merrill on what the optimal
21 time for a post-grant opposition procedure might be
22 to best promote the ultimate goal of having valid
23 patents.

1 MS. DeSANTI: I'll start if you want.

2 COMMISSIONER VALENTINE: Thank you, Susan.

3 MS. DeSANTI: And I will emphasize, again,
4 these are my own personal views, because the
5 Commission did not take any position on the timing
6 issue, which is the most difficult issue. Certainly,
7 nine months after seems like a reasonable time
8 period.

9 The question with respect to the second
10 window really has to do with the IT industries that
11 say, you know, we don't know when a patent is going
12 to pop out at us from somewhere. We had no idea
13 about this patent because, as Peter Detkin explained,
14 for semiconductors, for instance, there are 90,000
15 patents held by 10,000 companies that relate to
16 microprocessors, and so the IT companies explain that
17 having that nine-month window doesn't really do them
18 any good, because what they're concerned about are
19 patents that have already been issued that will pop
20 out of nowhere. The biotech companies, on the other
21 hand, will explain to you that their venture capital
22 funding is put at risk if, in fact, you don't stop at
23 the nine months, that they can't get the kinds of

1 investment they need. This is what they would say,
2 I'm taking their name in vain here so you'll have to
3 rely on me for that. But they are going to have
4 problems with their investments because they cannot
5 say to their investors, "Okay, this patent now is
6 presumed valid, and, you know, you can take it to
7 federal court, and it's got a presumption of
8 validity;" you couldn't say that if you had a nine-
9 month window.

10 I don't have a good solution for that problem. But I
11 see both sides as having very valid points.

12 COMMISSIONER VALENTINE: Okay. Mr. Pinkos
13 or Mr. Merrill, do either of you care to comment?

14 MR. PINKOS: Go ahead.

15 MR. MERRILL: We said a year as an initial
16 window and a second window, but at the discretion of
17 the district court, not at the discretion of parties
18 to dispute. I have no idea what the right term limit
19 is, and I dare say that we didn't have a firm
20 empirical basis for choosing one year over nine
21 months or 18 months. I think there is an argument in
22 starting up a new post-grant review system, not to
23 have it indefinitely open, because the number of

1 cases should be contained initially.

2 COMMISSIONER VALENTINE: Okay.

3 MR. MERRILL: But I don't know what the
4 right number is, frankly.

5 COMMISSIONER VALENTINE: Okay. Mr. Pinkos.

6 MR. PINKOS: I can't give you a specific
7 answer right now.

8 COMMISSIONER VALENTINE: Okay. Feel free to
9 write it.

10 MR. PINKOS: The administration is working
11 up a specific position on that. As many of you have
12 been in the administration before, I can't speak
13 prematurely, but we're considering many of the issues
14 that were just discussed.

15 COMMISSIONER VALENTINE: Perfect; please let
16 us know when you get a position. Better information
17 disclosure -- Mr. Pinkos' statement indicates that
18 voluminous citations really are a problem. One
19 proposed suggestion is when more than 25 references
20 are cited, the PTO may require applicants to identify
21 which parts are relevant to the case and why the
22 applicant believes each reference is relevant. Mr.
23 Stack, I understand you oppose the FTC's proposal to

1 allow examiners to request when there are voluminous
2 submissions to explain the relevance of the ones;
3 would you accept or endorse Mr. Pinkos's proposal?

4 MR. STACK: Again, to say that I advance at
5 AIPLA --

6 COMMISSIONER VALENTINE: AIPLA had said in
7 its statement that you submitted for them that they
8 oppose the FTC.

9 MR. STACK: Right, and I don't have an
10 answer on the specific question with respect to Mr.
11 Pinkos, but I will provide one.

12 COMMISSIONER VALENTINE: Thank you. And,
13 Ms. DeSanti, any thoughts on Mr. Pinkos's proposal?

14 MS. DeSANTI: I think it's a great proposal.

15 COMMISSIONER VALENTINE: Thank you. Could I
16 ask one quick question on eliminating inequitable
17 conduct defenses? I think that I see Mr. Merrill
18 recommending the elimination of the defense and Mr.
19 Stack also, or -- I don't intend to totally identify
20 with your testimony, but your testimony supporting
21 the elimination, I think, is recommending that the
22 PTO, as an administrative matter, would then find
23 fraud, and then whether or not one brought an

1 antitrust case, a *Walker Process* case, would occur
2 only after that.

3 I would be interested in Ms. DeSanti's and
4 Mr. Lemley's, and I guess after that anyone else's,
5 to the extent we have time, thoughts on eliminating
6 inequitable-conduct defenses and what repercussions
7 that might have or how we might accommodate or
8 compensate for that with *Walker Process* and antitrust
9 claims.

10 MS. DeSANTI: That's not an issue that we
11 specifically studied, so I don't know that we know
12 enough based on the record we created to have a view.
13 I will say that there were some significant concerns
14 expressed at our hearings about the PTO's capability
15 to deal with the inequitable conduct issue. That
16 issue was within the domain of the PTO many years
17 ago, and it was found that it was a very difficult
18 mission for the PTO. The PTO has a very different
19 mission in general, as patents come in, patent
20 applications come in, to examine them, rather than to
21 be fraud investigators, and that concern was raised,
22 so I simply bring that to your attention.

23 COMMISSIONER VALENTINE: Okay.

1 PROFESSOR LEMLEY: To me, this is tied to
2 the question of hold-up and litigation abuse. If we
3 have reforms in place that deal with those problems,
4 I can live with elimination of inequitable conduct as
5 a litigation defense, because as Mr. Merrill's report
6 points out, it does add significantly to the cost and
7 uncertainty of litigation.

8 But I'd hate to see us in the name of patent
9 reform make it easier for people who want to game the
10 system to get through the Patent Office by deceiving
11 the Patent Office and getting a patent that they can
12 then use for a nuisance value hold up or something
13 else. So I'd be reluctant to weaken the inequitable
14 conduct defense unless I were confident that we also
15 dealt with the problem of litigation abuse.

16 COMMISSIONER VALENTINE: Mr. Pinkos or Mr.
17 Detkin or anyone, or Mr. Stack, sure.

18 MR. STACK: I have one thought; you do have
19 to think about collateral-estoppel implications if
20 you decide to turn this into an administrative
21 proceeding before the PTO. You've got issues about
22 right to jury trial. If you look at the convergence,
23 and it's not complete, but it's almost complete,

1 between inequitable conduct and fraud, you've got
2 very little more to argue if you've been found guilty
3 of inequitable conduct when you're defending a fraud
4 case in court. And in that situation, it seems to me
5 one could make the argument that it ought not to -- a
6 finding by the PTO ought not to have collateral-
7 estoppel effect and you ought to be able to bring the
8 whole factual matrix before the court *de novo*.

9 MR. DETKIN: A quick comment; as a
10 practitioner, I can't emphasize enough that what --
11 the CFC's words, which is that the inequitable-
12 conduct defense has become a plague; it's brought up
13 in every case, and it does consume massive amounts of
14 resources to defend. Having said that, I also want
15 to echo Mark's comments, which is that there are some
16 cases where it's appropriate, and we don't want to
17 throw the baby out with the bath water. And I do
18 think that H.R. 2795's approach is a reasonable
19 accommodation of trying to balance those two
20 interests.

21 COMMISSIONER VALENTINE: Okay, thank you
22 very much.

23 CHAIRPERSON GARZA: Okay. Commissioner

1 Kempf.

2 COMMISSIONER KEMPF: Yes, Mr. Stack; you
3 said that you weren't a patent lawyer; you were an
4 antitrust lawyer like the members of the Commission.
5 I'm not sure I think of myself as an antitrust
6 lawyer. I think of myself as a trial lawyer, and it
7 was my great good fortune to try a lot of antitrust
8 cases during my career, which I found to be
9 interesting, but, like Commissioner Warden, I don't
10 view the antitrust laws as trumping the patent laws.
11 He said he thought that the IP laws were of equal
12 standing; I'm not sure that there are not more than
13 that. I mean after all, they were around 100 -- well
14 over 100 years before anybody even figured out we
15 needed antitrust laws, and they reside in the
16 Constitution, where things like free speech and the
17 right of assembly reside.

18 And I sort of think of things as taking
19 their roots out of the Constitution as pretty
20 important stuff. So as between them, I'm not sure
21 that I wouldn't go beyond even what Commissioner
22 Warden said and view them -- if there's an inequity
23 that resides in the intellectual property direction.

1 To pick up on Peter's comment there,
2 inequitable-conduct defense -- the Federal Circuit is
3 doing a pretty rigorous job itself. The cases all
4 may have it, but they -- you need a pretty compelling
5 case by the time you get there. Three things, Mr.
6 Detkin: first, you refer to your Stanford Business
7 School paper --

8 MR. DETKIN: No, I'm sorry, lecture.

9 COMMISSIONER KEMPF: -- lecture. That's my
10 question: does it reside in a paper, and if so, can
11 you send that to us?

12 MR. DETKIN: It doesn't; it resides in a
13 series of PowerPoint slides I could probably send to
14 you.

15 COMMISSIONER KEMPF: Yeah -- no, I'd welcome
16 an opportunity to see those.

17 MR. DETKIN: Okay.

18 COMMISSIONER KEMPF: Second, in 25 words or
19 less, you've been doing a pretty good job of
20 rebutting Professor Lemley as you've gone along, but
21 if there's anything else you want to pick up on that
22 you haven't yet done, you can do it in 25 words or
23 less. I don't mean literally 25 words or less, but I

1 don't want to give you all my time to use for your
2 rebuttal.

3 MR. DETKIN: I appreciate that, and
4 actually, I think I've gotten two of my three points
5 in. The only, third, point I'd make, and this is
6 actually not one that I feel strongly about, but I
7 think it needs to be aired -- Mark said that there's
8 no controversy about harmonization referring to first
9 to file. There's no controversy in this room, most
10 likely, but there is significant controversy out
11 there about first to file.

12 People claim that the U.S. patent system is
13 unique. We shouldn't be following European patent
14 system just for the sake of following it, and well,
15 that's -- I'm giving you the argument that's out
16 there. I'm not, you know, like some other people on
17 the panel, I don't speak for myself on this one, but
18 they feel it's, you know, steal America's inventions
19 act. So you're going to hear a lot about that if
20 you, you know, pursue this line of inquiry, if you're
21 that interested, so there is controversy, just not in
22 this room.

23 COMMISSIONER KEMPF: Okay. Finally, on the

1 patent troll subject, in your written submission you
2 have, well, gee, under that definition -- would be
3 patent trolls, Dean Kamen would be a patent troll. I
4 think the reason you may be a little thin skinned on
5 this is that, I think people would say, "No, no,
6 you're the poster child for patent troll, so you are
7 the quintessential definition of a patent troll."

8 And my question is this: if I define a
9 patent troll as someone who goes around the
10 countryside and acquires patents for no other
11 purpose, and does -- let me park a little bit -- does
12 no inventive activity on their own, and does those
13 for the purpose of determining whether they're good
14 patents or not, and then if they are, enforcing them,
15 what's wrong with that? I would take it you'd say
16 nothing, but I'm looking for an elaborate defense.

17 MR. DETKIN: Well, there are a lot of
18 assumptions in there, and I don't think, you know,
19 I'd like to see the question in writing, it's almost
20 like an interrogatory here, which is kind of how I
21 think you meant it. I don't think there's anything
22 wrong with what you said. Assuming that they are
23 valid patents and the claims that are being made have

1 validity and aren't simply being made for the purpose
2 of receiving a nuisance value. I mean there are
3 people out there, for example, who acquire patents,
4 send letters to 50,000 people looking for a
5 settlement of 10 to 20,000, because it's cheaper to
6 settle than get an opinion letter; that's not what I
7 heard you say.

8 COMMISSIONER KEMPF: No.

9 MR. DETKIN: I would say that there is
10 something wrong -- I mean the first one smacks of
11 patent ambulance chasing; what I heard you say was a
12 different scenario. So I just want to make sure I
13 distinguish between the two.

14 COMMISSIONER KEMPF: Correct; I'm looking
15 for someone who's going out -- this person has no
16 inventive skill at all, but he does have
17 entrepreneurial skill, and they say, "Hey, you know,
18 I can go out and acquire good patents" (the
19 terminology we use, "high quality patents"), "and
20 what I'm going to do is buy them cheap and enforce
21 them dear," and you seem so defensive on it --

22 MR. DETKIN: Really, I'm not --

23 COMMISSIONER KEMPF: -- and the reason I ask

1 the question is that it doesn't strike me that
2 there's a problem with that.

3 MR. DETKIN: No, I'm sorry it comes across
4 as defensive. Believe me, I'm not thin skinned on
5 this or much else, frankly, at this point in my
6 career. But, you know, rephrasing your question,
7 what I hear you saying is, is there anything wrong
8 with compensating an inventor for inventing, allowing
9 him to go back to invent, and then using those rights
10 -- licensing those rights? No, of course not.

11 COMMISSIONER KEMPF: Okay.

12 CHAIRPERSON GARZA: Okay. Commissioner
13 Jacobson.

14 COMMISSIONER JACOBSON: I can't resist a
15 little bit of history. Antitrust law actually really
16 dates back at least to Roman times, the prohibition -
17 - and price fixing certainly dates back to 1415, when
18 the *Dyer's* case was decided, and both of those
19 certainly antedate the -- ability to grant patent
20 rights. So I think we have a somewhat longer
21 pedigree, but I agree with the fundamental
22 proposition that both laws should be construed to
23 promote innovation, and if properly construed,

1 they're complements rather than inconsistent with
2 each other.

3 With regard to Professor Lemley's questions
4 about standard-setting, I'm going to venture the
5 view, which I will stand to be corrected on later,
6 that there is absolutely no dispute whatsoever within
7 this Commission that a standard-setting body's
8 requirement of *ex-ante* disclosure of royalty prices
9 by applicants is *per se* lawful, and that one of the
10 reasons we elected not to address this specific
11 issue, despite numerous requests from a number of
12 companies, is that we really didn't think that was
13 open to much dispute.

14 The closer question, which we didn't think
15 was that close, was the one addressed in the speech
16 given by Chairman Majoras a couple of months ago.
17 And I don't think you're going to get better
18 certainty on that one than rule of reason treatment,
19 because you can't say it's *per se* lawful for people
20 to sit down and agree on prices because they can do
21 other things at the same time. So I think all the
22 clarity that the intellectual property community
23 wants in terms of standard setting is out there, and

1 I, you know, maybe this Commission will address the
2 issue in its report; that hasn't been determined, but
3 I don't think it's the burning problem that has been
4 presented to us. Go ahead.

5 PROFESSOR LEMLEY: So I hope you're right.
6 I guess I haven't seen sort of anything in court
7 decisions or guidelines that sort of leads me to have
8 a comfort level to saying that there is *per se*
9 legality for the disclosure, not just the disclosure
10 of the existence of patents, but disclosure of
11 licensing terms, but I hope you're right.

12 COMMISSIONER JACOBSON: Well, I would refer
13 you, although it doesn't address this issue in -- to
14 the ABA's book on standard setting that was published
15 last year, and the general standards set out in that
16 book I think make clear the point that I was just
17 trying to address.

18 I want to get back to the subject at hand,
19 which is the patent system and antitrust, and focus
20 particularly on the issue of post-grant review, which
21 we've talked about a little bit. If there is a nine-
22 or 12-month window after the grant rather than after
23 the notice of infringement, does anyone disagree that

1 we need then to continue to reexamine the issue of
2 standard of proof of invalidity when the case gets to
3 court? And let me start with Mr. Detkin on that. If
4 we're going to hold the post-grant review period to a
5 fixed nine months after the grant, shouldn't we be
6 looking at revising clear and convincing?

7 MR. DETKIN: I don't believe so. I believe
8 that a patent grant needs to mean something, and
9 clear and convincing does not mean absolute; it's
10 still overcome all the time in court, but I think
11 it's appropriate that someone attacking a patent be
12 able to come forth with clear and convincing
13 evidence.

14 COMMISSIONER JACOBSON: Do others agree with
15 Mr. Detkin on that point?

16 PROFESSOR LEMLEY: No, I disagree. I think
17 it's actually important to look at the standard. As
18 Commissioner Warden pointed out, one of the reasons
19 that we see various kinds of bad patents issue is
20 that, on obviousness grounds, the Patent Office has
21 the burden of demonstrating disentanglement to a
22 patent. An applicant never has to show any reason
23 why they should be entitled to a patent in the first

1 instance; the burden starts on the Patent Office.

2 Given that, it seems -- and given the
3 burdens that were discussed in the amount of time
4 spent evaluating, the clear and convincing evidence
5 presumption doesn't seem, to me, warranted. But I
6 agree with what I think is the spirit of your
7 question, which is if we could find a way using post-
8 grant opposition or something else to identify those
9 patents that are important, give them additional
10 scrutiny, we could then justify a very high
11 presumption of validity in court.

12 MR. STACK: I would say that the AIPLA
13 agrees with Mr. Detkin. And it might be instructive
14 to look at the written commentary that they put in,
15 because they've tried to analyze this question in a
16 slightly more sophisticated way, and I think where
17 they come out on it is to say that, with respect to
18 the underlying facts, you ought to retain the clear
19 and convincing evidence standard because it's so easy
20 to fabricate a prior invention case. But with
21 respect to the legal conclusion that comes out of
22 those facts, then it's a straight preponderance of
23 the evidence test.

1 COMMISSIONER JACOBSON: Well, except
2 obviousness is inherently factual, isn't it? I mean
3 there's no dispute on what the law is on obviousness.
4 Every case involving obviousness depends on the
5 facts, so that doesn't seem to me to be much of a
6 distinction; is it?

7 MR. STACK: It may relate more to
8 anticipation, I'm not sure. But in any event, if
9 that's the case, I think AIPLA's position would be
10 that -- along the lines of what Mr. Detkin said, you
11 ought to stick with the clear and convincing
12 standard.

13 COMMISSIONER JACOBSON: Before we get back
14 to Mr. -- I just want to hear from Ms. DeSanti, if
15 she has a position or has insight into the FTC's view
16 on these subjects.

17 MS. DeSANTI: Yes, and again, emphasizing
18 these are my own views, when we reviewed the AIPLA's
19 commentary on our report, we did research the issue
20 that they raised on the distinction between fact
21 versus law. And there are two responses; one is that
22 that distinction about factual evidence requiring
23 clear and convincing evidence was developed with

1 respect to oral testimony that is very easy to
2 fabricate. However, if you look at the kinds of
3 factual issues that are often coming up in
4 obviousness cases, these days, those are not
5 typically about oral testimony that would be easy to
6 fabricate, but, in fact, are more relevant to the
7 kinds of documents that may exist in the outside that
8 have -- that can show whether there was prior art
9 sufficient to suggest the invention that's being
10 claimed is not new and non-obvious.

11 And in the course of this, Mr. Jacobson, I
12 would hope you would -- Commissioner Jacobson, I
13 would hope you would indulge me in simply saying, in
14 response to Commissioner Warden's earlier question
15 about whether the PTO reads *Graham v. Deere*, I don't
16 think the question is so much whether the PTO reads
17 *Graham v. Deere* as whether the Federal Circuit reads
18 *Graham v. Deere*.

19 COMMISSIONER WARDEN: I concur.

20 MS. DeSANTI: And, in fact, there is a case
21 that may go to the Supreme Court on this. The
22 Supreme Court has asked for the government's views in
23 this case, on whether they should grant *certiorari* on

1 this case involving the non-obviousness standard.

2 COMMISSIONER JACOBSON: Okay. My time has
3 expired, but I interrupted Mr. Detkin twice, so equal
4 time.

5 MR. DETKIN: I appreciate it. Inherent in
6 your question and inherent in Professor Lemley's
7 answer is the underlying assumption that there are a
8 lot of bad patents out there, similar to Commissioner
9 Warden's comments. But again, where's the data on
10 that? Everybody makes --

11 COMMISSIONER JACOBSON: I'll -- my own view,
12 it's completely anecdotal, and it is based on the
13 experience that I've seen, which is advising clients
14 defending utterly bogus patent suits, and
15 unfortunately, we're all affected by our own
16 anecdotes, and the cases that I see as an antitrust
17 lawyer involving allegations of fraud on the Patent
18 Office, both prosecuting those and defending them,
19 and what I've seen is that the evidence of fraud in
20 each case, at least if you believe the allegations,
21 and some of the deposition testimony is shocking, and
22 that based on my --

23 MR. DETKIN: That's a different --

1 COMMISSIONER JACOBSON: -- limited
2 experience, the amount of concealment of prior art at
3 the PTO is breathtaking, and very troublesome to me,
4 again, without any, you know, solid, empirical data,
5 just based on years of observation.

6 MR. DETKIN: That is a very different issue,
7 though. That gets to the issue of fraud, inequitable
8 conduct, and withholding of information. I agree,
9 that is a troublesome issue, but that is different.

10 COMMISSIONER JACOBSON: It's not an
11 isolated.

12 MR. DETKIN: Excuse me, let me finish,
13 that's different than looking at the claims of a
14 patent and determining that it never should have
15 issued in the first place. For example, everybody
16 makes fun of the Amazon one-click patent, except
17 everybody always talks about, I don't know, have any
18 of you folks ever read that? I know you have -- keep
19 your hand down, Mark -- but other than Mark, has
20 anybody in this room read that patent?

21 COMMISSIONER JACOBSON: I try not to read
22 patents myself because my reading comprehension is --

23 MR. DETKIN: Okay. So if you don't read

1 patents, well, you just fell right into my trap. If
2 you're not going to read the patents, then how are
3 you going to sit and criticize their claims and
4 criticize their scope and validity?

5 COMMISSIONER JACOBSON: Well, what I can --
6 what I have seen, and I wouldn't say fraud is an
7 unrelated issue, when the fraud is concealment of
8 prior art, then the issue of obviousness and whether
9 the patent should have issued -- is squarely
10 presented, and that, again, I have no scientific data
11 on this, but it's one of the things that makes the
12 clear and convincing standard to me, personally,
13 extremely troubling and difficult, and while it seems
14 to me a sensible solution to give the patent
15 practitioner some level of certainty is to say, okay,
16 nine months; it's not going to be indefinite; it's
17 not going to be when a notice of infringement is
18 issued, but let's modify the clear and convincing
19 evidence standard. The burden of proof is still
20 going to be on the alleged infringer, but let's not
21 make it impossible, let's make it a burden that can
22 be satisfied. That's just one person's point of
23 view.

1 CHAIRPERSON GARZA: All right, and 12
2 minutes worth.

3 COMMISSIONER JACOBSON: I've been under my
4 time more often than not, so I'm guilty as charged.

5 CHAIRPERSON GARZA: I think -- but we want
6 to move on, unless, Mr. Detkin, there's some very,
7 very short reply that you have to make. Okay.
8 Debra, I'm going to exercise my --

9 COMMISSIONER VALENTINE: No, absolutely. I
10 just -- I wanted one clarification, which is the case
11 that Susan is referring to --

12 CHAIRPERSON GARZA: I was going to ask her
13 about that.

14 COMMISSIONER VALENTINE: Oh, okay. I think
15 it's *Teleflex*, okay.

16 CHAIRPERSON GARZA: Actually, I'll make it
17 the first one. Ms. DeSanti, actually, I did want to
18 mention, there is a case in your testimony, I think
19 it's on page seven, and footnote six, where you
20 mention that the FTC had filed a -- or the FTC was
21 involved in a petition for *certiorari* that had been
22 filed in a patent case, *Teleflex versus KSR*; is that
23 the one that you meant to refer to just now in your

1 oral testimony?

2 MS. DeSANTI: Yes, and the FTC did not file
3 the petition for *certiorari* --

4 CHAIRPERSON GARZA: No, but --

5 MS. DeSANTI: -- but the Supreme Court has
6 requested the Solicitor General to provide the
7 government's views on whether to -- whether, in fact,
8 to grant that petition, and we'll just have to wait
9 and see what the Solicitor General does with that.
10 But it is a case of interest. It goes to one of the
11 legal tests for obviousness that the FTC criticized
12 in its report.

13 CHAIRPERSON GARZA: And is that the
14 commercial success or --

15 MS. DeSANTI: No, it is the so called
16 suggestion test. It has to do with the issue of
17 whether -- when you have two different sources of --
18 let me give you the garbage bag case; this is the
19 easiest way to understand it. In the garbage bag,
20 so-called garbage bag case, which is referenced in
21 our Report, and I can give you the page and cite, the
22 PTO found to be obvious, a so called invention that
23 combined a garbage bag and a picture of a jack-o-

1 lantern put on the garbage bag for fall leaf
2 collection, okay, and the PTO found that to be
3 obvious.

4 MR. LEMLEY: Non-obvious.

5 MS. DeSANTI: No, the PTO found that to be
6 obvious, Mark. Okay. The Federal Circuit, however,
7 found it non-obvious, and criticized the PTO for not
8 having found a specific writing or some other very
9 specific evidence that would show that a suggestion
10 had previously existed to combine those two elements.
11 That's the issue that's at issue in the *Teleflex*
12 case. And I will say the technology is relatively
13 simple in that case, so it may be a case that you
14 want to follow. Some of these cases, we have found
15 are very difficult to follow.

16 MR. DETKIN: The good news is, it probably
17 took less than 18 hours to examine that application,
18 saving time for other applications.

19 COMMISSIONER JACOBSON: They got that one
20 right.

21 CHAIRPERSON GARZA: Mr. Merrill, in your
22 testimony earlier, you were talking about the
23 cautious approach that the academies have taken in

1 regard to their recommendation on approving the
2 quality of patents, and you mentioned a couple of
3 things I think that you said occurred post you
4 report, one was the peer review that had been done of
5 biotech patents; is that -- and is there something
6 public on that?

7 MR. MERRILL: Yes, it was published in
8 *Science Magazine*. I think it was done out of
9 Northwestern Kent.

10 CHAIRPERSON GARZA: What did they use for
11 the -- what did the people --

12 MR. MERRILL: They used a panel of legal
13 practitioners.

14 CHAIRPERSON GARZA: But they looked at the
15 applications that had gone to the PTO or they were
16 looking at litigated --

17 MR. MERRILL: Applications and issued
18 patents.

19 CHAIRPERSON GARZA: Okay. And then the
20 survey by IP owners of their membership, which
21 reflected that the -- reflected that they thought
22 there were patents being issued that shouldn't be?

23 MR. MERRILL: I don't remember the numbers.

1 It was published within the last couple of months.

2 CHAIRPERSON GARZA: Where was that
3 published?

4 MR. MERRILL: I assume on their web site.

5 CHAIRPERSON GARZA: Okay. And what's the
6 name of the organization, IP --

7 MR. MERRILL: Intellectual Property Owners.

8 CHAIRPERSON GARZA: Oh, okay, all right,
9 thank you. Now, Ms. DeSanti, one other thing I think
10 I read was that the FTC intended itself to become
11 involved in potentially raising questions about bad
12 patents; what has the FTC been doing, if anything,
13 that you can tell us about?

14 MS. DeSANTI: The FTC has not raised that --
15 has not gone to the PTO with a request for
16 reexamination of any particular patents. However, we
17 remain open to questions that people may have about
18 particular patents, that people believe have
19 significant competitive effects. Obviously, there
20 are bad patents, unlike the, you know, the famous
21 peanut-butter sandwich; that is not the subject of
22 the FTC's interest, but rather, are there really
23 questionable patents that have significant

1 competitive effects such that it might be appropriate
2 for the Commission to consider referring the patent
3 to the PTO for reexamination? That's a difficult
4 topic for us because there's, obviously, a limit to
5 our patent expertise.

6 CHAIRPERSON GARZA: Well, that's one of the
7 reasons I asked. And also, I take it that doesn't
8 require the creation of any kind of post-grant review
9 process?

10 MS. DeSANTI: No.

11 CHAIRPERSON GARZA: And would the notion be
12 that the FTC would do this in response to some sort
13 of petitioner request or notice from parties, or
14 what's the idea that you would examine something on
15 your own to come up --

16 MS. DeSANTI: No, the notion is not that the
17 FTC would examine anything on its own; the notion is
18 to refer it to the PTO as a patent that should be
19 reexamined but to leave the examination process with
20 the PTO. The reason being, however -- the reason for
21 the reexamination would be related to the significant
22 competitive effects and questions that had been
23 raised about the patent's validity.

1 CHAIRPERSON GARZA: Okay. Another question
2 I had is, in your testimony, you suggest that an area
3 that might be most fruitful for this Commission to
4 consider is the recommendation of the -- bucket of
5 recommendations the FTC made to somehow or another
6 inject new economic learning or economic learning
7 into the processes of the Patent Trademark Office,
8 and also the Federal Circuit, but I wasn't clear
9 exactly what that means. How would you have the PTO
10 incorporate economic learning into what it does in
11 examining the validity of patents?

12 MS. DeSANTI: Well, let me give you one
13 example. Let me first say what we're not talking
14 about. We're not talking about individual patent
15 applications being assessed in terms of their
16 competitive significance. However, the PTO does
17 issue guidelines for examination, and in the context
18 of those guidelines for examination, it can consider
19 what kinds of rules to develop. The proposal is
20 simply that the rules that are developed by the PTO,
21 in its examination guidelines, and the rules that the
22 Federal Circuit develops, for example, for non-
23 obviousness, how to determine non-obviousness, should

1 include consideration of economic and competition
2 policy considerations.

3 And I don't want you to think that this is
4 novel. This whole notion of paying attention to the
5 competition that surrounds patents and ensuring that
6 what is meant to be in the public domain stays in the
7 public domain and is subject to competition can be
8 found in Supreme Court cases, in Supreme Court patent
9 cases as well.

10 This is simply a proposal for the Federal
11 Circuit, which has recently, in a recent case,
12 announced that it does not consider such policy
13 considerations to be worth -- something that it
14 should address or take into account in making
15 decisions, and for the PTO in issuing its own
16 examination guidelines, to take those kinds of
17 competition policy considerations into account. I'm
18 happy to go on at length, but maybe -- I want to be
19 responsive, so let me stop here.

20 CHAIRPERSON GARZA: I'm violating my own
21 rules, but Mr. Stack, I think your organization,
22 which you do or don't represent today, opposed the
23 position that Ms. DeSanti just described to us. Can

1 you explain in 25 words or less around that, what the
2 basis of the opposition is?

3 MR. STACK: I think it was based on the
4 misunderstanding that Ms. DeSanti just said. I think
5 they were proceeding from the assumption that what
6 was being advocated was individual consideration,
7 patent by patent, of competitive effects. I'm not so
8 sure that they would come to the same recommendation
9 on a more general level.

10 CHAIRPERSON GARZA: Thank you. Thank you
11 very much to our panelists, again, for the statements
12 that you submitted and for your testimony today.

13 COMMISSIONER VALENTINE: We technically have
14 four more minutes. Could we just ask if any other
15 panelists have any thoughts on Susan's proposal? I'd
16 be particularly interested in Mr. Pinkos and Mr.
17 Lemley; is that fair?

18 CHAIRPERSON GARZA: If you're willing to
19 stay seated and respond, that's fine.

20 COMMISSIONER VALENTINE: You can go get a --
21 if you need to.

22 MR. PINKOS: I've not examined it in great
23 detail, but I know that it potentially could be

1 difficult to interject economic or competitive
2 analysis into the patent examination process. I just
3 -- even under some tightly defined criteria, what
4 exactly would the examiners be looking at, or what
5 type of guidelines would be issued? I don't think
6 that we can venture to guess how economically viable
7 a particular idea may be, or even how it could affect
8 the marketplace in a certain technology. I just -- I
9 think I certainly would be happy to have discussions
10 at a greater length at the staff level to talk about
11 the ideas, but just on a threshold level, it seems
12 very difficult for our Office to undertake.

13 CHAIRPERSON GARZA: We might ask for -- we
14 might follow up in another forum with you, Susan, and
15 the FTC, to get a bit of a better idea of what kinds
16 of things you think are appropriate.

17 COMMISSIONER VALENTINE: I don't think the
18 economic viability was what she was getting at.

19 PROFESSOR LEMLEY: So I think the FTC is
20 absolutely right on this. I mean, you know, for
21 better or worse, the Patent Office is making economic
22 policy. I mean their decisions as to the legal
23 standards are economic policy, and it seems crazy to

1 me to think that we want to do that blindly, and not
2 actually consult economic wisdom. It doesn't mean,
3 of course, it should be determinative, but, you know,
4 just as the antitrust agencies look, in thinking
5 about policies and guidelines, to the advice of the
6 economists on their staff, it would be nice to have
7 the same opportunity provided in the Patent Office.

8 COMMISSIONER VALENTINE: Thanks for that
9 question, though, Deb.

10 CHAIRPERSON GARZA: All right. Well, thank
11 you very much. I should mention that all of the
12 testimony provided, the written testimony will be
13 posted on the AMC web site, if it's not there
14 already, and at some point we will have a transcript
15 of today's proceedings that I believe we share with
16 the panelists to make any corrections, and so you
17 will be hearing from us at least to that extent.
18 Thank you again.

19 COMMISSIONER VALENTINE: Thank you all very
20 much; that was very helpful.

21 (Whereupon, at 2:45 p.m., the hearing was
22 adjourned.)

23

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